THE INTERNATIONAL VIDEO INDUSTRY: PRINCIPLES FOR VERTICAL AGREEMENTS AND INTEGRATION

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The international media industry is already enormously concentrated. In a mood of deregulation that may lead to further future mergers, ownership and concentration rules are being struck down by courts and reconsidered by the Federal Communications Commission.[1] Further concentration may occur as a result of foreign deregulation decisions, such as those being considered by the United Kingdom.[2]

This paper argues that such increased concentration is unhealthy for the marketplace of ideas. Further, it goes beyond previous analyses in its argument that the various network externalities of the media industry make vertical arrangements between content products and content distributors likely to have significant anticompetitive implications.[3] Nevertheless, many aspects of the analysis of this paper are applicable to Internet issues as well. There is a serious risk of use of Internet portals to control the contents accessible through the Internet, in ways parallel to the agreements between content producers and content distributors discussed in the article. One example is posed by Microsoft's grant of better place-

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1 *See, e.g., Media Ownership Policy Reexamination, at* http://www.fcc.gov/ownership. (last updated Jan. 20, 2004). Among the key recent court decisions are Sinclair Broad. Group, Inc. v. FCC, 284 F.3d 148 (D.C. Cir. 2002) (explaining local TV common ownership rule); Fox Television Stations, Inc. v. FCC, 280 F.3d 1027 (D.C. Cir. 2002) (illustrating national TV and TV/cable ownership rule); Time Warner Entertainment Co. v. FCC, 240 F.3d 1126 (D.C. Cir. 2001) (stating horizontal and vertical cable ownership limits). In the Telecommunications Act of 1996, Congress weakened a number of these rules and directed the FCC to review them to see whether they "are necessary in the public interest as a result of competition." Telecommunications Act of 1996, Pub. L. No. 104-104, § 202(h), 110 Stat. 56 (2003). *See generally Sinclair Broadcast. Group, supra.*

2 *See Communications White Paper: A New Future for Communications,* U.K. Department of Trade and Industry, *at* http://www.communicationwhitepaper.gov.uk. (Dec. 2000) (last visited Mar. 1, 2004) [hereinafter *U.K. Communications White Paper*].

3 For many, the video system plays a less important role in distributing information than the written press, the various international news agencies, and the emerging Internet in providing access to data and a means for informal distribution of information. Many of the entities involved in such forms of news distribution are members of the global conglomerates to be discussed in the text, yet concentration in this news area is probably less than in the video area. Certainly, anyone seeking access to information has a greater possibility of being able to use a number of independent sources. Hence, the issues are different enough that they will not be considered in the basic model discussed in this paper.

ment of icons to call attention to specific internet service providers and internet content providers in return for various commitments by them to favor its browser marketing strategy.[4] Another example is illustrated by the possibility that AOL would have preferential access to Time Warner cable customers, an issue at the center of the Federal Trade Commission's review of the AOL/Time Warner merger.[5] An excellent piece has recently argued that concentration in the media context is dangerous for the marketplace of ideas and should be analyzed from a perspective that goes beyond traditional economic analysis.[6] And there has also been significant discussion of vertical media relations in the context of the 1996 Time Warner-Turner merger.[7] This paper emphasizes how the vertical issues affect the marketplace of ideas and how the network externalities affect the vertical issues. It also goes beyond previous work by considering international trade law issues and ways to respond at the international level, through negotiations at the World Trade Organization (WTO), as well as at the national level, through regulatory and competition law standards.

The first part of the paper reviews two important current trends in the global delivery of video programming. These trends provide background for an economic model, which is developed in the second part, and take into account the economics of information and of network externalities presented in the second part. The third part derives normative implications from the economic analysis, taking into account national and international freedom of speech issues. The fourth part places those implications in the context of actual domestic and international law. The final part proposes specific reforms concentrating on vertical issues within the industry, including competition and access-oriented standards. It supports these reforms on both economic and free speech principles, and suggests their implementation, not only in national law but also in audiovisual service agreements as might be negotiated under the auspices of the WTO.

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[4] *See* United States v. Microsoft Corp., 87 F. Supp. 2d 30 (D. D.C. 2000), *rev'd in part,* 253 F.3d 34 (D.C. Cir. 2001).

[5] *See* U.S. Federal Trade Commission, America Online, Inc. and Time Warner Inc., Decision and Order, *In re America Online, Inc., and Time Warner Inc.,* Docket No. C-3989, *available at* http://www.ftc.gov/os/2000/12/index.htm.

[6] *See* Maurice E. Stucke & Allen P. Grunes, *Antitrust and the Marketplace of Ideas,* 69 ANTITRUST L. J. 249 (2001).

[7] *See* S. Besen et al., *Vertical and Horizontal Ownership in Cable TV: Time Warner-Turner, in* THE ANTITRUST REVOLUTION: ECONOMICS, COMPETITION, AND POLICY 452 (John E. Kwoka & Laurence J. White eds., 3d ed. 1999).

I. CURRENT TRENDS

The global video distribution system is shedding the paradigm of broadcast television and changing in two important dimensions.

A. *Emergence of a Two-Tier Production and Distribution System*

At one time, video programming was delivered from fixed sites to specific urban regions. The firm or agency that held the franchise for the specific region was responsible for the programming (a responsibility that was often delegated, in part, to networks). The working economic concept was of a vertically integrated system, in which program production would be integrated with program distribution. Funding was provided entirely through advertising. Competition among different local channels and among the networks would provide a basis for both economic competition for advertising funds as well as intellectual competition for the viewer's attention. In some nations, funding was provided by the government and intellectual competition was created, if at all, through production of programs by different groups.

Today, the fixed stations are being supplemented by "multiple system operators," (MSOs), including both cable and direct broadcast satellite systems. In the United States, over 67% of homes have cable service,[8] as compared with 19.9% in 1980.[9] Another 15% obtain multichannel access through direct-to-home satellite systems.[10] In both cable and satellite systems, the viewer is provided, via the local franchisee or the satellite, with a large number of channels, most of which are bought from other providers. It then distributes these channels for a fee, which varies depending on which channels or specific programs are purchased. The cable MSOs are required to carry local broadcast channels. This leaves the local stations with a basis for obtaining advertising revenue: the viewer gains access to these stations; to a variety of network-like channels included in the price of the cable system; and also to a number of pay-per-view opportunities.[11] Current satellite systems offer the viewer access to a much broader array of channels. Their tradi-

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[8] *See In re* Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, Eighth Annual Report, 17 FCC Rcd 1244, 1255 (2002) [hereinafter *Eighth Annual Report*].

[9] *See* 2001 U.S. CENSUS BUREAU U.S. STAT. ABSTRACT 705 tbl. 1126.

[10] Calculated from *Eighth Annual Report*, 17 FCC Rcd at 1272.

[11] *See* 47 U.S.C. §§ 534 – 535 (2003). These are the "must carry" rules of the Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, 106 Stat. 1468, §§ 4 - 5 (2003) (passed over President Bush's veto). They were challenged by the industry and upheld in *Turner Broad. System v. FCC*, 520 U.S. 180 (1997). In addition, there are copyright provisions relating to cable television at 17 U.S.C. § 111 (2003).

tional relation to network channels was quite different, but under recent legislation, satellite systems can carry such channels provided they also carry competing local channels.[12]

The move to MSOs, and particularly to satellites (including satellites feeding local cable systems) is global.[13] In the United Kingdom, for example, Rupert Murdoch's News Corporation's BSkyB has a monopoly of satellite transmission,[14] and some 16% of the market,[15] an amount greater than the cable share, but in contrast to the United States, is growing more slowly than the cable share. In Germany, where the infrastructure in the East was weak, the satellite share is 29% and cable 48%. And the systems are becoming far more significant in many developing nations, where it is easier to deliver satellite signals to a wide region than to build a cable system or a network of local stations. Murdoch's STAR television system (which is not his only satellite system) reaches 300 million viewers in 53 countries across Asia.[16] Murdoch is working to create similar services in Japan and in much of Latin America. Murdoch also had similar plans for a United States service, which broke down in wrangling with partners in early 1997,[17] and his effort to purchase a U.S. satellite firm, DirectTV, failed in 2001, when another competitor offered a bid for the firm.[18]

The key implication of these trends is that the viewer's choice of a small number of vertically integrated broadcast stations is being replaced by a two-tier pattern of many content providers which provide a variety of channels to the consumer through MSOs (broadcast, cable, or satellite) that will reach every home in the developed world and many in the developing world. Some of the content will be traditional video programming; some will be more interactive programming; and some may come from the Internet.

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[12] *See* Satellite Home Viewer's Improvement Act of 1999, Pub. L. No. 106-113, 113 Stat. 1501A-523; *see also* Satellite Broad. and Communications Assn. v. FCC, 275 F.3d 337 (4th Cir. 2001) (upholding and discussing the Satellite Home Viewer's Improvement Act).

[13] For a good, though dated, introduction to these markets, *see* Massimo Motta & Michele Polo, *Concentration and Public Policies in the Broad. Industry: The Future of Television,* ECON. POLICY, Oct. 1997, at 295.

[14] The Independent Broadcasting Authority originally granted authority to two groups to operate competing services; due to economic difficulties, the groups merged under Murdoch's control in 1990. *See* Re BSB Holdings Ltd. [1996] 1 B.C.L.C. 155; Mark Williams, *Sky Wars: The OFT Review of Pay-TV,* 8 EUR. COMPETITION L.REV. 214 (1997).

[15] *See* Carles Llorens-Maluquer, *European Responses to Bottlenecks in Digital Pay-TV: Impacts on Pluralism and Competition Policy,* 16 CARDOZO ARTS & ENT. L. J. 557, 583-584 (1998) (presenting statistics from the International Telecommunications Union 1996/97 Report).

[16] *See* data from Star Television website, *at* http://www.startv.com (last visited Mar. 1, 2004).

[17] *See id; see also* News Corp, Form 20-F, F.Y. 1997 (filed with the Securities and Exchange Commission Jan. 5., 1998).

[18] *See Another Twist in the Tale,* THE ECONOMIST, Aug. 11, 2001, at 50.

Under the old system of a few vertically integrated TV stations using the public radio spectrum, the regulatory structure (especially in the United States) emphasized diversity of content and ownership. Today, there are many more channels available on cable or satellite and privatization is extensive. The economics are thus different and are being perceived as more competitive. The regulatory rules, which assumed scarcity of radio spectrum, are routinely under attack in this new world.[19]

Several sources of further change are already apparent, but are unlikely to modify this pattern. Under the Telecommunications Act of 1996,[20] local phone companies may install the necessary systems to carry high bandwidth signals for video programming, which then may be delivered to television sets or to computer terminals. Similarly, cable providers may install the technology to deliver telephone and Internet services. Video signals are also now being transmitted over wideband Internet, i.e., cable-based Internet or DSL-based internet, and time-shifted or edited by various forms of recorder or set-top device such as TiVo. These systems will, in essence, lead to new forms of MSOs.

In a separate development, digitization is likely over the next decade. This will permit improved signal characteristics, a larger number of channels, and greater interconnectivity between computer-oriented and video-oriented systems. All U.S. television broadcasting is to shift to digital mode by 2006, subject to certain extensions,[21] and one-fifth of United Kingdom homes currently have digital television.[22] Although there are surprises in the evolution of telecommunications technologies, digitization appears more likely to change the technical characteristics of the signal than the economic structure of the industry. The surprises might come from detailed technical management of signal distribution by content providers through new technological mechanisms, which might not only prevent copying but also achieve new forms of price discrimination and distribution control.

B. *Global Integration (Vertical and Horizontal)*

At the same time that the industry has adopted a two-tier structure and the traditional regulatory structure is under attack, con-

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19 For the rules regulating the United States, *see supra* note 1. For the rules regulating the United Kingdom, *see supra* note 2.

20 Telecommunications Act of 1996, Pub. L. No. 104-104, § 302, 110 Stat. 56 (2003).

21 *See* Title III of the Balanced Budget Act of 1997, Pub. L. No. 105-33, 11 Stat. 251 (2003) (enacted by 47 U.S.C. § 309(j) (2003)).

22 *See U.K. Communications White Paper*, *supra* note 2, ¶ 3.3.3.

centration has struck, at least among the largest and most important firms. The most readily noticed trend is the creation of a few vertically integrated firms that control both MSOs (or large numbers of TV stations) and program production, including news programs and, in some cases, sports franchises. The leading groups and a few of their holdings are:

Disney:	Walt Disney Pictures and associated production groups, Anaheim sports franchises, ESPN, ABC, Disney Channel, TV stations.
Time-Warner:	Warner Bros, Atlanta sports franchises, CNN, TNT, HBO, cable franchises, movie theaters, satellite TV (under DOJ review).
Viacom:	Paramount, MTV, CBS, Movie Channel, Nickelodeon, TV stations.
News Corp.:	Twentieth Century Fox, New York and Los Angeles sports franchises, Sports Channel, FOX channels, TV stations, U.K. and Asia satellite TV.
TCI:	Discovery Channel, International Channel, Starz, cable franchises, U.S. and cable interests abroad.
Vivendi:	Canal +, Universal Studios, USA Entertainment.[23]

There has been recent questions as to the success of certain of these mergers, particularly in the context of the stock-market falls of firms such as Vivendi and AOL/Time-Warner. The greatest problems, at the time of this writing, have been for firms attempting to integrate traditional video markets and internet markets; integration within the video and video distribution sectors has not yet come under focused market attack. Within the video industry, the level of integration is clearly substantial, and affects a significant portion of program production. It is unlikely that the integration will be restricted by the Federal Communications Commission, which, as already noted, has been under both political and judicial pressure to weaken its various anti-concentration rules. It is not just the United States that is moving this way; other nations, such as the United Kingdom, are enacting legislation designed in part to ease restrictions on mergers in the media area.[24]

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[23] Adapted and updated from Mark C. Miller, *TV: The Nature of the Beast*, THE NATION, June 8, 1998, at 11. At the time of this writing, there was talk that NewsCorp might buy Canal + from Vivendi, which was in financial difficulty.

[24] *See U.K. Communications White Paper*, *supra* note 2 (discussing the Communications Bill to implement the recommendations, which was introduced in May 2002); Ernst & Young, *Charting a Route Through the Media Landscape: The Implications of the Communications Bill*, TECHNOLOGY, COMMUNICATIONS & ENTERTAINMENT (May 2002).

C. *The Task of This Paper*

It is this integration that most sharply poses issues for the future. One can argue that what has happened is that the oligopoly of ABC, NBC, and CBS has expanded to a much broader global oligopoly of Disney, Time-Warner etc., and that the consumer has the benefit of significantly more channels. This is true, yet today, the consumer is frequently served by a single MSO, who has a monopoly or near-monopoly position. Should the satellite systems become dominant, there will be a real question as to global control of distribution by a small number of firms. And there is a serious question of whether the relations between an MSO and the program producer who owns it, or has a special relation with it, will in fact give the consumer the benefit of either economic competition for the supply of the video service or of intellectual competition for quality programming and news presentation.

II. The Economics of Video Media

This section develops a general model of a two-tier system, using video production and distribution as a working example, of the economics of media production and distribution, including a careful analysis of the relations between content producers and distributors. It envisions a content production market and a distribution or MSO market, exemplified in the typical case discussed here, by a movie or TV studio (or sport league) as the content producer, and a cable, broadcast, or satellite TV system as the distributor or MSO. With obvious adjustments, the analysis could also be applied to Internet distribution through Internet Service Providers (ISPs) and DSL services or to international news agencies and syndicates distributing through local newspapers. It is true that the two-tier model does not apply to all situations – people still watch local TV stations and go to movies or sports events in person, but it has become dominant enough that it is used as a paradigm to use to balance that of the vertically integrated single broadcast TV station producing its own programs.[25]

A. *The Economics of Video Content*

Modern technology has made the copying and distribution of

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[25] The economic analysis of the older vertically integrated system concentrated on models of programming behavior with advertiser support or sometimes viewer support, and emphasized the economic pressures for TV stations to offer similar programming designed to offer a mass audience to advertisers. *See, e.g.*, Bruce M. Owen & Steven S. Wildman, Video Economics 99-100 (1992).

information nearly costless; however, the production of that information remains expensive. This is strongly exemplified in the new electronic media — the production of a television program is expensive, but in contrast, the costs of copying or distributing over a cable or television system are small.

Pricing theories necessarily therefore become highly artificial.[26] The economically "correct" cost of a program to a consumer should be the marginal cost of providing the program to that person. This cost is normally very small and provides no basis for recovering the cost of production from the viewers. If there is to be any incentive for development of new programming, however, the viewers must be charged much more than the marginal cost. This explains the need for intellectual property protection — by prohibiting copying (which is nearly costless), the original producer is able to keep others from undercutting the market.

Each specific program is a quasi-monopoly, for each is different. Viewers choose a program on bases such as reputation, advertising, or loyalty to a particular star or athletic team, so that one program may not be a close substitute for another. Thus, to the extent that copying can be prevented, the program-holder can seek a monopoly price – subject to some risk of competition based on the possibility of customer defection to a different program. In order to increase their monopoly rent, producers will divide markets to obtain the benefits of price discrimination. Thus, they will sell a movie at one price in a first-run theater and at another price, later, in videotape or television form.

Three points should be noted that further complicate the traditional marginal-cost pricing model. First, in many cases, the customer is not the viewer, but an advertiser. Thus, for many programs, the advertisers often pay the costs of producing and (smaller) costs of distributing the information. These advertisers then seek to sell their own products by presenting their message. The same has traditionally been true of the newspaper industry. In such a case, the program producer may be interested only in reaching as large a documentable audience as possible, and not care about copying.

Second, there is a significant information asymmetry. The viewer must commit to paying money, or at least time, before learning about the quality of the program. Therefore, reputation and

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[26] *See* John R. Woodbury, *Comment: Welfare Analysis and the Video Marketplace*, *in* VIDEO MEDIA COMPETITION: REGULATION, ECONOMICS, AND TECHNOLOGY 274 (Eli M. Noam ed. Columbia Univ. Press 1985).

advertising are important (and advertising constitutes a large portion of the cost of movies, for example).

Third, the content producer may gain a significant portion of its economic return from using the program as a form of advertising for related products. Toys based on movie characters are the obvious example, but it is not hard to see the same pattern at work in museum gift shops or in retail stores carrying merchandise with franchised monograms from sports teams.

These factors combine to produce a variety of network externalities, by which a successful content producer gains advantages over a less successful one. The popularity of a program or a movie may encourage others to want to view it. The more popular a TV series, the more advertisers will contribute and the more valuable the franchising rights for merchandise. Moreover, the larger the audience, the greater the ability of the producer to amortize production costs. To the extent this larger audience is predictable, the producer can allocate greater investments to the program, and can therefore compete more effectively in product quality. Greater expenditures do not necessarily translate into better programs, but they can help, as through hiring better-known stars – or sports players – and they also allow greater investment in promotion. Moreover, for the conglomerates, the ability to advertise programs through different media and to obtain financial return through these mediums may again provide a competitive advantage.

Of course, these advantages are not decisive and the factors just described conflict with the video executive's inability to predict the interests of possible audiences. There can be a market tipping, as in computer software, but the possibility of this must be balanced against viewer fickleness. People's tastes change and few, if any television or movie executives manage to predict what the consumer will want in the future. Every now and then, an upstart can successfully enter the market, and the pattern is one of a continuous tension between the real advantages of the market leader and occasional emergence of an upstart. Moreover, perhaps because of the increasing number of distribution channels available, the number of program producers has continued to grow. The number of satellite-delivered national programming services in the United States, for example, has gone from 106 in 1994 to 245 in 1998 and 294 in 2001.[27]

[27] *See In re* Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming, First Annual Report, 9 FCC Rcd 7442, 7514 (1994) [hereinafter *First Annual Report*]; *In re* Annual Assessment of the Status of Competition in Markets for

But neither this statistic, nor the impressive mergers described earlier present an entirely accurate picture. Many of the new channels are in fringe markets or are owned by one of the majors listed above,[28] and there is a rather substantial degree of concentration in important submarkets. Only four full-time news channels, two of which are CNN channels, are available in one California suburb;[29] there are only seven major U.S. movie studios which obtain 80% of box office revenues and only one new studio, DreamWorks, has entered this list during the last 75 years.[30] Thus, this is a market with an oligopoly at the top and a large competitive fringe at the bottom.

B. *The Economics of Distribution*

The key monopoly from the consumers' perspective may be that of the MSO. Within the two-tier system discussed here, the viewer can get access to programs only through the MSO and is therefore at the MSOs mercy both for cost and content. The MSO is only rarely a formal monopoly, and where it is, this is typically the result of a deliberate government decision. The real potential for competition, which depends on the details of the national regulatory system, is between different technologies, such as cable, satellite, and local stations. This competition can work over the long run, as exemplified by the move to satellite MSOs in the United States and to cable MSOs in the United Kingdom. It thus provides some competitive pressure on the MSO to keep rates from escalating too much and to carry channels and programs that have substantial public demand. Nevertheless, consumers will normally switch systems only as a result of a significant expected improvement in the quality/cost ratio, so that the shorter-term effectiveness of this competition is limited.[31] Moreover, in multi-dwelling units, the consumer may find it very difficult to orchestrate a

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the Delivery of Video Programming, *Fifth Annual Report*, 13 FCC Rcd 24284 (1998) [hereinafter *Fifth Annual Report*]; *see also Eighth Annual Report*, 17 FCC Rcd at 1609.

[28] The various channels are listed in *Eighth Annual Report*, 17 FCC Rcd at 1269.

[29] This is based on the author's personal knowledge of the AT&T cable connection in Los Altos, CA.

[30] *See* David Demers, *Media Concentration in the United States*, Center for Global Media Studies *at* http://www.cem.ulaval.ca/conc%83tatsunis.pdf (last visited Mar. 1, 2004).

[31] It is possible for the consumer to use a switch to connect to alternate channels, e.g. broadcast or cable. How many consumers will do this is questionable. Flexibility may change should there be significant growth in the wide-band Internet market. *See British Interactive Broadcasting*, Case IV/36.539, Commission Decision of September 15, 1999, O.J. 1999 L312 (mentioning, but not presenting BskyB's "churn rate," which was treated as confidential, and saying that "the fact that satellite customers may have purchased a satellite set-top box and/or satellite dish does not create such a significant lock-in effect that switching between satellite and cable services is unlikely." *Id.* at 5).

change.[32] There may also be a trend toward a broadband connection with a set-top box that brings all services, including video and telephone, into a home through a sole provider, meaning that the cable operator or the controller of the software through which programming is distributed on the cable may have monopoly power. Hence, there is, in fact, in all cases (even direct broadcast TV where there are regulatory barriers to entry) some form of market power.

This is essential, because almost all MSOs must, like content providers, charge prices above marginal costs, because essentially all their costs (except for program acquisition and perhaps promotional costs) are fixed costs. It is expensive to lay the cable or build the satellite – but serving one more home normally costs little, and the cable or satellite investment is expended whether or not programs are carried or viewers watch the programs. At a more detailed level, the economics of the MSO vary somewhat from technology to technology. The MSO will normally have to pay content providers for the programs it carries – there are exceptions, of course, if that content is supported by advertising (or third-party markets, such as toy sales), in which case the content supplier may either provide the content free or even subsidize it. For example, in order to obtain access for his new news channel, Fox News, Murdoch is alleged to have paid the U.S. cable operators $10 per subscriber.[33] In order to cover its operating costs and to obtain content, the MSO will then sell advertising (as in the case of a local broadcast station) or charge viewers a fee, as in the case of satellite or cable television. As with essentially all other prices here, this must be viewed not as a price that reflects marginal costs, but as one reflecting an effort to recover fixed costs in a situation of imperfect monopoly.

To the extent that there are horizontal economies of scale, there may be an inherent incentive toward horizontal integration of the delivery services. The cost of building a delivery system is enormous, but the marginal cost of enabling that system to reach an additional home may be small. This is radically the case for satellite or broadcast that can reach many homes as cheaply as one, and may also be the case for in-town viewers of a cable system. The studies suggest some slight economies of scale in the distribution area – with one recent study finding a decline in the economies of

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[32] *See Eighth Annual Report*, 17 FCC Rcd at 1265.

[33] *See Stop press*, THE ECONOMIST, July 4, 1998, at 17, 18.

scale over time.[34] An earlier study found some economies of scale, but saw them in "economies of scope" or "joint production" more than of households passed.[35]

But there is horizontal integration far beyond that required by these technological economies of scale. Clearly, the economies of scale in reaching additional houses do not explain the facts that AT&T has a 16% market share and TimeWarner has a 14% share.[36] Both firms are associated with the conglomerates listed above. Integration at this level brings economic benefits only, if at all, through permitting greater spreading of relatively fixed transaction costs of negotiating to buy programs and to sell advertising. It is also possible as will be discussed in the next section that a larger MSO is in a better position to negotiate terms with content suppliers.[37]

As with competition at the content level, neither overall numbers nor the dramatic mergers present an entirely accurate picture. In the United States, concentration in the cable television market has not recently been increasing.[38] Yet, the same may not be true globally, and there are certainly fewer entrants into the growing satellite market than in the less dynamic cable market. The previ-

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[34] *See* Stephen M. Law, *The Problem of Market Size for Canadian Cable Television Regulation*, *in* APPLIED ECONOMICS 87, 91-92 (2002).

[35] *See* Eli M. Noam, *Economies in Scale in Cable Television: A Multiproduct Analysis*, *in* VIDEO MEDIA COMPETITION, *supra* note 26, at 93. The author summarizes the analysis as follows:

> [T]he pro-separations argument [to separate content production from content distribution]. . . is normally presented as one of protection against a vertical extension of the natural monopoly in one stage of production (transmission) upstream into other stages such as program selection. The implications of our estimation, however, do not support the view that such advantages are primarily derived from a naturally monopolistic distribution stage. Instead the cost advantages appear to lie in the economies of scope (or integration), which provides cable television firms with some protection against rivalry in the distribution phase of their operations by other cable entrants.

Id. at 114-15.

[36] *See Eighth Annual Report*, 17 FCC Rcd at 1268. These numbers are down from four years earlier, when TCI (now AT&T) held a share of 26.5% and Time Warner held 16%. Apparently, however, the Herfindahl-Hirschman Index has fallen over time. *Cf. Fifth Annual Report*, *supra* note 27.

[37] Note that in some nations and with some technologies, there may also be an issue of "universal service," i.e., of ensuring that rural viewers have access in light of the fact that providing access for the isolated single customer may be much more expensive than providing access for closely-packed urban customers. Hence, a nation may seek to ensure that rural access is supported by a cross-subsidy from the fees paid by customers with easy access. It then becomes difficult to maintain competition, for the prices charged to customers with easy access can be undercut by firms entering with a different technology. This turns into an argument for equivalent regulatory treatment among different technologies. It will not be explored further in this paper.

[38] The recent *Eighth Annual Report*, *supra* note 8, estimates an HHI index of 905, down from 954 the previous year. This is down from the 1998 number of 1096, but up slightly from the 1994 number of 898. *See, e.g.*, *Fifth Annual Report*, *supra* note 27; *First Annual Report*, *supra* note 27.

ous discussion of Murdoch's power is one example. Or consider that Canal + held a 70% share of the French pay-TV market and has exclusive rights for about 87% of Hollywood's output as measured by box office receipts.[39] If there is an issue, it is that greater market share can translate into greater power over programming, an impact that depends on the types of vertical agreements permitted between content providers and MSOs. This is the issue to be discussed in the next section.

C. *Vertical Issues*

The economics of the content production and the MSO markets are complex, because neither type of firm is likely to be operating at an economic equilibrium at which marginal costs equal marginal revenues. Rather, the content provider seeks revenue and protection for its revenue in a situation that is, fundamentally, covering fixed costs; the distributor also seeks to recover fixed costs. Moreover, the content producer is subject to (or the beneficiary of) significant network externalities. What then is going on in a vertical merger or other vertical agreement?[40] Such arrangements are very common; for example, four of the top seven cable MSOs hold ownership interests in national programming networks, and nine of the top twenty video networks (measured by subscribership) are owned by cable operators.[41] Indeed, it is the interaction between the two markets in which the oligopolistic pattern is strongest. In its 1997 decision on the Time Warner/Turner merger, the Federal Trade Commission found high concentration in the sale of programming services to cable companies.[42]

Such an arrangement may bring significant benefits each way. The most obvious benefits go to the content producer and include:

1. Greater confidence of access to particular audience sizes, permitting allocation of fixed production costs over a larger base and more confident planning of larger investments in particular programs;
2. Opportunity to bar competitors from similar benefits and from particular portions of the audience market; and

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[39] *See TPS*, Case IV/36.237, Commission Decision of March 3, 1999, O.J. 1999 L90.

[40] For an excellent, albeit informal, analysis, *see Tangled Webs- Media conglomerates*, THE ECONOMIST, May 25, 2002, at 67-69.

[41] *See Eighth Annual Report*, 17 FCC Rcd at 1269.

[42] *In re* Time Warner, Inc., 123 F.T.C. 171 (1997) (stating that the "post-acquisition HHI for the sale of Cable Television Programming Services to [MSOs] in the United States measured on the basis of subscription revenues would increase by approximately 663 points, from 1549 to 2,212").

3. Opportunity to advertise its own content in ways otherwise unavailable.

For the distributor, there is a comparable benefit, but the greater benefit is probably in taking its portion of the benefits to the content producer and include:

> Greater confidence of the ability to obtain content of perceived quality high enough to attract viewers from competing distribution channels.
>
> Opportunity to obtain a share of the extra profit associated with the benefits to the content producer. This benefit may be shared through sale of content at a price lower than that available to other distributors or through sharing of the overall profits.

These benefits of a vertical relationship may be quite significant and their role is key to this model. Confidence of reaching a particular audience through such a relationship permits a more effective tailoring of content production costs and, if combined with exclusivity, can deprive content competitors of not only market size confidence but also of the market itself. These benefits to the content producer are directly dependent on the market coverage of the distributor with whom it has a relationship. Thus, the route to power in the content industry is in significant part through control of a substantial portion of the distribution industry. Additionally, part of the value of the distribution industry is in obtaining from the content industry a share of the rent associated with the content producer's desire to obtain preferential access to its customers. Because a vertical relationship can bring new ways to weaken a competitor, and because of the network externalities that help entrench a competitive position, vertical relationships cannot be viewed as benign as they can be in situations where there is more normal competition in the markets involved. There may be limited market power at the video level and the distribution level, but what power there is becomes significant depending on the terms of the vertical arrangements between the two levels.[43]

Details of some actual vertical agreements help suggest some of the practices by which firms take advantage of these benefits.

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[43] Note that the analysis in the text emphasizes competition in the content production market. This is also a concern about competition in the MSO market. *See* United States v. Tele-Communications Inc., 1996-2 Trade Cas. (CCH) ¶ 71,496 (D.D.C. Aug. 19, 1994) (Consent Judgment). The government explained its decree by saying that the vertically integrated merger might "have both the ability and incentive to lessen competition by discriminating against non-affiliated programmers in terms of access to its [MSOs], and by denying to competing [MSOs] access to its video programming on reasonable terms." *Id.*

Certain details of the programming arrangements of BSkyB are spelled out in a U.K. Office of Fair Trading study.[44] This satellite system provides programming directly to the consumer and indirectly, via supplying program packages, to cable services. BSkyB obtained exclusive broadcasting rights from five major Hollywood studios for a period before the first "terrestrial release window." It had exclusive contracts with certain sports leagues. And, both to the consumer and the cable system, it bundled channels. For example, one could not obtain the Disney Channel without also buying a number of BSkyB's other services. In a parallel situation, discussed in a recent proxy statement, AT&T Broadband Group provided "preferred vendor status with respect to access, timing, and placement of new programming services" to Liberty Media.[45] In connection with joint ventures to provide interactive video services, each committed that under certain circumstances, it would not provide competing services.

1. Exclusives

These examples exemplify practices that deserve specific attention before turning to actual vertical integration. One is the use of exclusives. Such exclusives are common, as with sports leagues. Clearly, some form of exclusive right, like one to ensure that no other MSO or TV system carry the same programming at the same time, is essential to encourage the program producer to invest in the costs of covering a sporting event, as well as to encourage the MSO to invest in program promotion (where this is a task assigned to the MSO). In these contexts, exclusivity serves much the same purpose as a copyright.

Exclusivity for a period longer than that needed for a reasonable planning, investment, and promotion cycle, however, becomes a way by which the rare possibility of entry into the MSO market (or transfer from, say cable to satellite system) can be deterred. The immediate impact here is on the distribution industry. BSkyB used its exclusives as part of a process of breaking into a market as a new MSO. But exclusives can equally be used to entrench the position of a specific MSO against its competitors.

The precise point at which these economic effects become im-

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44 *See id.* ¶ 77, 1617; *see also* Williams, *supra* note 14, at 214; Press Release, UK Office of Fair Trading, BskyB: The outcome of the OFT's Competition Act investigation, *available at* http://www.oft.gov.uk/news/press®eleases/2002/PN+89+02-OFT©oncludes+BskyBŋvestigation.htm (Dec. 17, 2002) [hereinafter Press Release].

45 *See* Comcast-AT&T joint proxy statement/prospectus, VII-8 to VII-9, *available at* http://www.att.com/ir/pdf/02proxy_ch_7.pdf (May 14, 2002).

portant is subject to reasonable judgment, but one might think of exclusives for less than a year or so as being acceptable because of their role in planning.[46] Longer exclusives would become problematic if granted to an MSO having a significant portion of the market. It is only such an MSO that is able to build the exclusive right into a serious tool of competitive advantage. And there are certainly situations, such as different networks each having their own news programs, in which the economic problems of exclusives are resolved by competition between the networks.

2. Packaging and Related Limitations

A very different issue is presented when the program producer insists that certain programs be taken together as a package. This practice is done on U.S. cable television, presumably in part for billing simplicity purposes, but can also be present in relations between content firms and MSOs. Thus, a content provider might require, in essence, that in order to obtain access to a channel strongly valued by the consumer, an MSO must also carry certain other channels. Here, in contrast to the use of exclusivity, the impact falls on the content production industry. In normal economic relationships, this sort of typing presents little harm. The increased profits on one product are overweighed by losses on other products.[47] Yet, under the economics of information, the result may be different. By obtaining access for the tied channel, the conglomerate may be able to increase the chance that the channel becomes a stronger, more dominant competitor, and can make it harder for competing program producers to enter the relevant submarket. Thus, under the specific circumstances of the economics of information, packaging becomes a way by which entry into the program production market can be discouraged. Since access to this market is the most crucial from an economic perspective, it is necessary to make a careful consideration of possible anticompetitive effects of any package arrangements.

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[46] One official from the European Union Competition Directorate has suggested a one season limitation in the sports context. *See* Alexander Schaub, Sports Competition: Broadcasting Rights of Sports Events, Address at the Jornada dia de la competencia (Feb. 26, 2002).

[47] While the analysis in the text builds on a network externality, there are arguments that block booking permits a form of price discrimination by taking advantage of the differing demand curves of different customers. *See* Steven S. Wildman & Bruce M. Owen, *Program Competition, Diversity, and Multichannel Bundling in the New Video Industry*, *in* VIDEO MEDIA COMPETITION, *supra* note 26, at 244, 255-58. Both theories are quite different from that used in old block booking cases. *See, e.g.*, United States v. Loew's, Inc., 371 U.S. 38 (1962); United States v. Paramount Pictures, Inc., 334 U.S. 131 (1948).

3. Refusal to Carry/Non-Competition Requirement

A fortiori, there should be serious concern about restrictions in which a producer of a popular program conditions access to that program on the MSOs not carrying a competitor's program. Liberty Media offers an example. This may be very understandable from the perspective of a program producer seeking to protect itself from competition. Yet, it is precisely the kind of situation that favors existing program creators and makes its harder to enter the program creation industry. Such restrictions should simply be prohibited.

4. Integration

With vertical integration, all the effects just described can take place, albeit typically as the result of management decision-making rather than formal contract. Moreover, with vertical integration, the large investment made in a program can be amortized across viewers in a more predictable way than is likely practical with contractual arrangements alone. This predictability can be a basis for competitive advantage in funding the information/program production, and in achieving advertising revenues. The video production company that owns a significant portion of a nation's cable or satellite distribution systems can thus plan to carry a program over that system, and allocate its costs more effectively than can its competitors. If it has control of a larger market, it can even allocate its costs in a way that allows it to undersell competitors for access to other MSOs. It cannot, of course, guarantee that anyone will watch - but it is in a stronger position than a competitor who cannot be confident of achieving carriage over an equally substantial video or cable system. At the same time, an MSO in a vertically integrated situation has more confident access to programming, and may be able to persuade viewers to switch to its MSO service as a result. Thus, vertical integration contributes to strengthening the network effects favoring horizontal integration or tipping in both the content and distribution markets.

As with the exclusivity issue discussed above, this use of network effects can benefit competition in the hands of an entrant, while hurting competition when in the hands of market leaders. Plausibly, for example, vertical integration played an important role in encouraging the initial development of the cable network industry in the United States. As of today, vertical relationships are substantial, but entry is still possible, as the number of national satellite-delivered cable programming services continues to in-

crease.[48] Moreover, there have been statistical studies demonstrating that U.S. vertically integrated MSOs do not discriminate against non-affiliates in the programs they carry.[49] Again, as in the other areas, there is reason to believe that these studies do not tell the entire story. The antitrust cases discussed above indicate that the desire for exclusive rights is quite strong. The fact of carriage says little about the terms of carriage. And entry into key sectors such as national news systems is quite difficult – with these important submarkets, it is very likely that vertical relationships will raise the effective barrier to entry.

D. *Making the Economic Analysis International*

The issues that have just been discussed are, in the realities of today's markets, deeply international. Certainly, the markets,[50] the mergers, and the ownership groups are themselves international. But the more important point is that the network effects described above also work internationally. If, for example, News Corp. has control over access to a larger number of subscribers outside the United States, it will be able to offer a better package of programs (in terms of price and financially-derived content) to underbid its competitors in providing programming to the United States MSO market.[51] Moreover, the conglomerates are capable of supplying pressure in one market to affect their competitive position in another, and are likewise susceptible to such pressure. For example, News Corp. was susceptible to pressure from the Chinese government to cancel carriage of BBC on its Asian satellite system.[52] And U.S. cable systems are alleged to have denied Murdoch access for its own programs, e.g. Fox News, in order to keep him from setting up a competing satellite system in the United States (this access was later provided when Murdoch slowed action on the satellite

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48 *See supra* notes 8-10 and accompanying text.

49 *See* Owen & Wildman, *supra* note 25, at 245-50; *see also* Besen et al., *supra* note 7, at 460-61 (analyzing the Time Warner-Turner merger as being heavily dependant on the details of the ownership interests involved in that case, rather than emphasizing the network externalities as is suggested by the analysis of this paper).

50 Note that market definitions must be carried out with full consideration of ownership and contractual positions in global markets. Moreover, competition in the content market may only be in a geographically limited market, such as local news, in contrast to coverage of the World Cup. Market power at the MSO level seems likely to be uniform in a global (or at least single language) market, perhaps weighted by the purchasing power of specific regions.

51 This assumes that it is making money in the markets in which it operates – a point that depends on the extent to which limitations on entry permit pricing, which recovers the various fixed costs.

52 *See* Jim Mann, *Murdoch China Dealings Spell Trouble*, L. A. Times, Mar. 4, 1998, at A5.

system).[53]

In an entirely separate effect, the existence of global trade in industry economically favors firms from nations with larger markets. In free trade, information-based firms that are dominant in larger home markets have a competitive advantage over firms in smaller markets and thus tend to dominate in international trade.[54] This is because firms in nations with larger markets are likely to spend more on content in the individual production in order to meet domestic competition, and are also likely to be able to recover a significant portion of those costs in the home market. Thus, they can export a better (or at least better funded) product at a lower price, and the nation is likely to export more content than it imports. Those with strong industries benefit from trade. Thus, the products of the United States movie industry are globally competitive – and the consequent returns strengthen Hollywood (even if certain Hollywood firms are owned offshore and production is made offshore). Except News Corp. itself, this phenomenon generally operates to the benefit of the United States and already established developed world program producers, compared with new developing nation entrants.

There are important limitations to this generalization about the economics of trade and entry. As always, the economic factors involved are factors of tendency, rather than definitive factors — a sluggish MSO can be replaced and an attractive upstart channel can find viewers. In cultural and intellectual areas in particular, it is common for completely new ideas to break upon the scene with substantial force. Moreover, despite the possibilities of dubbing and program adaptation, each linguistic and cultural group presents a different market. But the underlying tendency remains — greater concentration at either the content or the MSO level and toleration of more restrictive vertical practices in any major world market strengthens the tendencies toward concentration at both levels in other world markets.

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[53] *See* Complaint, United States v. Primestar, No. 98-CV-01193 (D.D.C. Filed May 12, 1998), *available at* http://www.usdoj.gov:80/atr/cases/f1700/1757.wpd.

[54] *See* Steven Wildman & Stephen Siwek, *The Economics of Trade in Recorded Media Products in a Multilingual World: Implications for National Media Policies, in* INTERNATIONAL MARKET IN FILM AND TELEVISION PROGRAMS 13 (Eli M. Noam & Joel C. Millionzi eds., 1993); *see also* John H. Barton, *Global Trade Issues in the New Millennium: The Economics of TRIPS: International Trade in Information-Intensive Products,* 33 GEO. WASH. INT'L L. REV. 473 (2001).

III. The Goals of Regulation: Integrating Economic Concerns with Freedom of speech Concerns

The video media play an important role in the international and national political processes. This is an issue of freedom of the press, focusing both on ensuring that citizens have access to diverse sources of information and commentary and on ensuring that a person with a message to present has a reasonable opportunity to present that message. Although much of that information may ultimately come from reporting for non-video media, many people gain most of their news information from the video media — over 60% in the United States[55] — and, the economics and incentive of the print media are naturally affected by the globalization of the video media. It is essential then, to integrate freedom of speech concerns with economic concerns.

A. *At the MSO Level*

At the strict economic level, it is clear that the MSO structure should be efficient, in the sense that programs are distributed to the viewer at as low a price as possible and using as technologically efficient a set of distribution of channels as possible. Clearly, in light of the imperfections of competition in the distribution sector, imperfections that are necessary if fixed costs are to be covered, the system is unlikely to ever be perfectly efficient in this dimension. And, compared to the other issues involved in this industry, efficiency in this dimension may be among the less important concerns, unless the relevant costs begin to seriously affect viewer access to entertainment and information.

But, in defining an optimal outcome, freedom of speech and information concerns become important. A citizen wants more than economic efficiency because this industry is about information and speech. (Certainly entertainment is part of that information/speech world, just as is news programming.) Hence, citizens have a reasonable desire that MSOs not have the ability to effectively censor their information, just as they do not want the government to censor it. This need not prevent traditional restrictions such as those on obscenity or libel, but it should certainly prevent restrictions on more political speech and programming. It also means that we should be hesitant about the dominance of large portions of the market by particular MSOs, and that, instead, we

[55] The Roper Organization, America's Watching, Public Attitudes Toward Television, poll commissioned by the Network Television Association and the National Association of Broadcasters (New York, 1995).

should prefer each viewer to have a choice of MSOs. At least in the United States, there is no dominance large enough to create a serious threat to overall control of programming. This may be less clear outside the United States, at least in areas where satellite distribution has become dominant. To make this principle against dominance difficult to apply in practice, its application must take into account a reasonable freedom on the part of the MSO to choose what content to carry in order to maintain viewer appeal.

B. *At the Content Level*

Defining an economically optimal outcome is far more difficult at the content level. Considering that this industry is necessarily recovering much more than marginal cost from each viewer, the closest that one can do economically to define an optimal level of pricing is to suggest that the total payments recovered from viewers should provide an economically reasonable rate of return on investment in producing programs, i.e. a rate of return comparable to that in other sectors. However, because the economics is so indeterminate, there is no reasonable way of saying that the market clears at a specific number of channels or content providers. The supply and demand curves are not shaped by a specific exchange between the content provider and the viewer, nor are the prices reflective of marginal costs. The concept of consumer demand is itself problematic, considering that the consumers' payments are often only indirectly related to the programs received, for the consumer pays in significant part through fixed cable fees or advertising included in the sale of goods. Moreover, taking into account consumer demand for programming, a level of return is obtained at a particular level of production. There are only so many movies or so many news channels. Nevertheless, the consumer has some impact based on the time he or she wants to spend watching media (a time which depends on the quality of the programming). Moreover, in calculating a rate of return, how should one treat investment in advertising or returns from sales of advertising or of franchised goods? The market is affected by the regulatory choices defining the numbers of broadcast stations or of channels to be carried on a cable or satellite. But recognizing the calculatory and theoretical difficulties, we would certainly question practices that allowed continued and regular returns well above a normal level.[56]

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[56] For the same reasons, it is very difficult to define efficiency in an economically relevant sense, save in very narrow ways that miss the important cross-subsidies and externalities that mark this sector. For example, a firm with a larger built-in market for a particular

In this context, however, the citizen has rather well defined free-speech goals of access to as broad a package of programming as possible. The citizen wants to have enough content producers available to provide a reasonable variety of perspectives and to respond to a reasonable variety of interests. The issue is not just economic competition, but also intellectual competition in providing quality news coverage or entertainment programs that reflect a variety of perspectives and interests. If there is too much concentration, there is a loss of choice and diversity, where diversity means access to new voices and voices representing different communities. The issue is especially important in the news context, where it seems plausible that a few channels may obtain a dominant position vis-a-vis global news.[57]

It may help the analysis to focus on an alternate (but also only loosely definable) standard of competitiveness that takes into account the viewer's free-speech goals. This will provide a reasonable possibility of creating a new source of content – i.e., for there to be a reasonable possibility of entry into the content market. Such a possibility means that a new point of view can emerge, displacing other points of view in a way that reflects market forces and public interests. As is clear from the analysis above, such entry is actually happening. But this is much less a matter of entry into the core, into the dominant oligopoly, than of entry into the competitive fringe. A reasonably robust possibility of turnover in the dominant oligopoly would be healthy, as it would give new perspectives a serious chance of being heard and keep the incumbents alert.[58] There is, of course, no way to quantify the appropriate level of feasibility of new entry into the market, but such feasibility is certainly essential.[59] Making entry feasible requires maintaining the ability to overcome network externalities. Moreover, it depends not only on

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type of programming is able to recoup greater profits without necessarily having greater efficiency in either program production or estimating the desires of audiences.

[57] Regional and local news programs, however, are doing very well. *See Eighth Annual Report*, 17 FCC Rcd at 1315.

[58] This can be compared with the economics of markets dominated by a standard that is supported by network externalities. The clear example is Microsoft Windows. The efficiencies provided by the standard must be placed in the balance with the costs of the monopoly power exercised by the standard holder. But, even if those efficiencies and the way the monopoly has been achieved allow us to permit the monopoly to be retained, we want to give competitors a chance to take over the monopoly every now and then, as the standard evolves into new markets and new generations. Otherwise, there is too little incentive for the standard holder to advance the technology.

[59] The issue is very similar to one way of analyzing the Microsoft antitrust situation. The market power – and benefits – of the Windows standard are both substantial. In order to insure that Microsoft will continue to innovate, however, it is essential that there be a chance that Microsoft could be displaced as technology evolves, e.g., via a transition from individual computers to Internet-oriented computers.

the character of the content production market, but also on the character of the MSO market and of the vertical arrangements that are permitted between the content producers and the MSOs.

C. *Internationally*

The key goals arising from the domestic context are thus, the prevention of MSO censorship and the encouragement of the possibility of entry into the content market, including entry into the more powerful core of content providers. The same analysis applies internationally. Any citizen anywhere would reasonably want access to programming from anywhere, subject only to the restrictions necessarily associated with the economics of delivery and with reasonable accommodation of concerns such as libel, copyright infringement, and obscenity. Subject to the same restrictions and to a recognition that others may not want to listen to him or her, the citizen would like to be able to speak to them. In short, to the extent it is possible, one would like both a global free market in entertainment and programming and to restrict governmental or private sector barriers to the flow of programming.

This may be an idealistic goal, and it is one that builds ultimately on a sense that all viewers have First-Amendment-type rights, not just U.S. viewers. But it also builds on a direct national self-interest. Given the importance of network externalities that operate at a global level, the foreign regulation of the video industry affects the programs available to U.S. viewers (and the converse effect of U.S. regulation on programs available abroad is even stronger). Moreover, it is in the interests of the citizens of each nation that free speech be available in other nations. After all, the future of that other nation is shaped by the information available to its citizens, and its future affects the futures of all other nations. The possibility that the Asian financial crisis derived in part from inadequate public information about financial markets has provided a reminder that transparency is in the interest of all.

Governments, of course, attempt to regulate the flow of information to their own citizens, as exemplified by restrictions on satellite reception. In July 1997, in resistance to incoming satellite signals, India prohibited the use of satellite TV systems, including the receivers.[60] China and Malaysia have similar rules.[61] Accord-

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[60] For a description of the Indian system, *see* Sevanti Ninan, *Broadcasting Reform in India: A Case Study in the Use of Comparative Media Law,* 5 CARDOZO J. INT'L & COMP. L. 335 (1997). On regulation of incoming channels, *see* Sevanti Ninan, *History of Indian Broadcasting Reform,* 5 CARDOZO J. INT'L & COMP. L. 341, 362 (1997) (citing Ministry of Communications Notification (1997), *reprinted in* Gazette of India Extraordinary, Jul. 16, 1997, at 4)).

ing to a survey of the law of a number of jurisdictions prepared by Paul, Weiss, Rifkind, Wharton & Garrison, Canada, France, Germany, Italy, Japan, and the United Kingdom all require some form of licensing of channels received from abroad.[62]

But the regulations may have effects far beyond national borders. In some cases, this is simply a practical matter. As noted above, Murdoch discontinued carrying BBC on his StarAsia system in response to Chinese pressure. Although it is not publicly documented that the action was taken in response to the criticism, Orbit, a Saudi-managed, Middle Eastern pay-TV satellite system based in Italy, stopped carrying the BBC in April 1996, shortly after the BBC published a program critical of the Saudi regime.[63] In both cases, viewers outside the complaining nation lost access to the programs as well. In some cases, nations seek to use leverage to shape coverage globally – here, the conglomerate structure increases vulnerability. In 1980, a United States PBS channel canceled a showing of a movie about a Saudi Arabian Princess in response to pressures from the Saudi Arabian government.[64] Both the Murdoch and the Disney empires have been pressured by China to shape ventures in a way that would protect China's image, and, in the cases we know of, have resisted. After equivocating, News Corp. refused to allow its subsidiary, HarperCollins, to publish a book on Chris Patten, the last British Governor General of Hong Kong.[65] Disney refused to cave, rejecting arguments from China that it should not publish a movie about Tibet.[66]

IV. The Structure of the Law

A. *Domestic*

In general, the regulation of the media reflects a combination of economic factors and of national freedom of speech concerns. The details in both areas often go back to a broadcast TV pattern, in which the economic viability of the industry was achieved

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[61] China limits satellite reception to luxury hotels, foreign housing, and companies that can demonstrate a business need. *See* Maggie Farley, *China Launches Get-Tough Policy on Foreign Satellite TV Programming*, L. A. TIMES, May 8, 1999, at C1. The Malaysian rule permits certain small satellite antennas designed to receive signals from only a domestic satellite system. *See* Phillip L. Spector et al., *Survey of National Broadcasting, Cable, and DTH Satellite Laws*, 5 CARDOZO J. INT'L & COMP. L. 715, 757 (1997).

[62] *See* Spector et al., *supra* note 61.

[63] *See* Edmund Ghareeb, *New Media and the Information Revolution in the Arab World: An Assessment*, 54 MIDDLE E. J. 395 (2000).

[64] *See* Muir v. Alabama Educ. Television Comm'n, 688 F.2d 1033, 1037 (5th Cir. 1982).

[65] *See* Mann, *supra* note 52, at 26.

[66] *See* Robert Scheer, *Murdoch Lets Us See a Real China Dealer*, L. A. TIMES, Mar. 10, 1998, at B7.

through scarcity of outlets (as in the United States), through subsidy (as in countries where there is a national or publicly-owned television system), or even through special taxes (as in the UK where TV set holders pay a fee that supports content production.)[67] In these situations, the equivalent freedom of the press is obtained by a combination of independence of the content creating entities (U.S. networks or public agencies in national systems) and of principles encouraging diversity of ownership.

Typically, this regulation is administered by a national authority, such as, the United States Federal Communications Commission, created by the Communications Act of 1934,[68] that seeks to integrate the relevant economic and content policies. Administrative Regulation of the Media may also be done through a national television authority or publicly owned system (although the global trend is, of course, towards privatization). This special-purpose regulation may, as in the United States and Europe, be supplemented by antitrust regulation that seeks to ensure as much economic efficiency as possible in the system. There have been previous strong and persuasive arguments proposing that antitrust or administrative agency regulation of the media should take freedom of speech concerns into account.[69]

Often, the protection of diversity and of local cultural autonomy is an important goal in national regulation. Thus, the various United States ownership and license rules were designed to achieve diversity by attempting to distribute broadcast licenses in order to ensure that the media reflected a number of different perspectives. In many nations, the desire to protect local cultural perspectives has gone further and has been a basis, not just for local content restrictions, but also for serious objections to incoming programs, even in basically democratic nations. European television rules, for example, require that a certain portion of the programming be provided by local sources.[70] This is both a protectionist measure to

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[67] Wireless Telegraphy Act of 1949, 12, 13, & 14 Geo. 6, Chap. 54, § 2, as amended (Eng.).

[68] Act of June 19, 1934, Pub. L. No. 73-416, 48 Stat. 1064 (2003) (codified at 47 U.S.C. § 151).

[69] *See, e.g.*, Stucke & Grunes, *supra* note 6. For consideration of a broader range of political concerns, *see* Robert Pitofsky, *The Political Content of Antitrust*, 127 U. PA. L. REV. 1051 (1979).

[70] *See* Council Directive 89/552/EEC of 3 October 1989 on the Coordination of Certain Provisions Laid Down by Law, Regulation or Administrative Action in Member States Concerning the Pursuit of Television Broadcasting Activities, 1989 O.J. (L298) 23, as Amended by Directive Pursuit 97/36/EEC of the European Parliament and of the Council of 30 June 1997 Amending Council Directive 89/552/EEC on the Coordination of Certain Provisions Laid Down by Law, Regulation or Administrative Action in Member States Concerning the Pursuit of Television Broadcasting Activities, 1997 O.J. (L 202) 60.

support European content creation industries and a cultural diversity measure to try to ensure that viewers have alternatives to programs produced by leading program exporters, such as the United States. Canada also has a strong history of concern about cultural protection.[71]

Needless to say, there are also nations that strongly seek to control access to television, typically through control over the programs that are transmitted nationally. This may be done through national ownership of the media, or through various forms of censorship. To supplement domestic control, nations may also seek, as noted above, to control incoming information channels, typically using either cultural protection or national sovereignty arguments. To the extent that it has technologically effective control, a nation can de facto deny information to its people. Technological control of the media is becoming more difficult, however, and not just with respect to information coming through the Internet, as satellite antennas are becoming quite small and blocking the signal itself remains impractical. Nevertheless, national restrictions can still be economically significant, for the nation can effectively prevent any form of payment by the viewer to the satellite operator and also make it difficult to estimate the size of the market for purposes of selling advertising.

B. *International Economic Regulation*

Internationally, the key rules are those of the Services Code negotiated under the Uruguay Round.[72] This is a framework agreement for trade in services, which reflects an application of international free market principles to the services area. Such an international free market can bring many of the same kinds of benefits achieved by competition law at the national level to the international level. The Services Code requires procedural transparency in the regulation of all services and most favored na-

[71] Nevertheless, the United States has successfully negotiated trade action to weaken Canadian restrictions on cable carriage of a U.S. country music station. *See* Gary G. Yerkey, *U.S. Country Network to Begin Broadcasting in Canada This Fall, Ending Long Trade Dispute,* 13 Int'l Trade Rep. (BNA) No. 33, at 1304 (Aug. 14, 1996); Andrew M. Carlson, *The Country Music Television Dispute: An Illustration of the Tensions Between Canadian Cultural Protectionism and American Entertainment Exports,* 6 MINN. J. GLOBAL TRADE 585 (1997).

[72] *See* General Agreement on Trade in Services, Apr. 15. 1994, Marrakesh Agreement Establishing the World Trade Organization, *reprinted in* 33 I.L.M. 44 (1994). The International Telecommunications Union is involved in the international regulation of the technical characteristics of global television, but is not nearly as important in the economic and speech issues considered in this paper. On the WTO perspective, *see generally* WTO Doc. S/C/W/40, *Council for Trade and Services - Audiovisual Services: Background Note by the Secretariat, available at* http://docsonline.wto.org/DDFDocuments/t/S/C/W40.DOC (Jun. 15, 1998).

tion (MFN) treatment of foreign firms providing services. It also provides a mechanism for negotiating market openings in the World Trade Organization (WTO) with respect to services including what are called "audiovisual" services in WTO parlance. It thus envisions a series of supplemental negotiations governing specific service areas in which nations will open up commercial access to these areas on a reciprocal basis; national treatment of foreign providers is normally negotiated in these areas.

The precise applicability of this agreement and of the WTO procedures generally are a matter of some dispute. The original General Agreement on Tariffs and Trade (GATT), which was the predecessor to the WTO, included a provision on cinematograph films (Article IV), expressly permitting screen quotas reserving time for national films (which were not to be increased beyond 1947 levels) and prohibiting import allocation arrangements with respect to the non-quota time. During the Uruguay Round the United States and Europe, who appear to have agreed to disagree for five years on this issue, failed to reach a consensus as to whether the new agreement applies to audiovisual services.[73]

Nevertheless, this has become an area for negotiation at the WTO, and nations have been submitting proposals for agreements that may be achieved during the Doha round of negotiations. If negotiations in other areas are an indication, one of the important issues that would be governed in any such agreement is whether or not foreign firms can purchase national television stations. Reciprocal opening of such markets has been a major theme of international negotiations under the Services Code. (The United States has legislation prohibiting the foreign ownership of TV stations).[74] Another important issue that will almost certainly be covered is whether there should be further negotiations affecting the international media industry and the legitimacy of domestic content requirements.

Currently, the negotiating position of the United States is less far reaching. The Clinton administration sought an understanding as to the definition of the audiovisual sector, a definition of appro-

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[73] *See* Sandrine Cahn & Daniel Schimmel, *The Cultural Exception: Does it Exist in GATT and GATS Frameworks? How Does it Affect or is it Affected by the Agreement on TRIPS?*, 15 CARDOZO ARTS & ENT. L. J. 281 (1997). Cahn & Schimmel also describe how there was an explicit cultural exclusion in the Article 2005 of the Canada-United States Free Trade Agreement, Jan. 2, 1988, 27 I.L.M. 281 (1988), which was then incorporated by reference into Annex 2106 of the NORTH AMERICAN FREE TRADE AGREEMENT, Dec. 8, 1992, 32 I.L.M. 605 (1993).

[74] 47 U.S.C. § 310(b) (2003). The FCC interprets this section as preventing foreign ownership of DBS satellites. *See In re* Matter of Policies and Rules for the Direct Broadcast Satellite Service, IB Docket No. 98-21, June 13, 2002, ¶ 2.

priate services disciplines, and an understanding on subsidies to the area.[75] The Bush administration's executive summary of its position has not been quite so specific, seeking commitments to maintain existing levels of openness.[76] Other positions available at this writing include Brazil's, which calls for recognition of diversity concerns. Such concerns include arguing that subsidies are not enough, that the industry had an oligopolistic structure, and that films are "placed at 'dumping' levels in foreign markets, since most of the cost of production has already been recouped in the home market of the producing country."[77]

Switzerland's communication added a new point important for this paper, that:

> [T]he audio-visual sector is characterized by high entry barriers, both as regards to the production and the distribution of content. This tendency has even intensified as a result of the IT-revolution and the digitization of the audio-visual contents. A growing vertical integration across the industry reinforces the fears of anti-competitive behaviors such as abuse of dominant positions. This tendency impacts not only the functioning of the audio-visual market per se, but also tends to induce a homogenization and a leveling of the supply of contents. For these reasons, it seems that the competition dimension of the regulation of the audio-visual sector deserves some discussion.[78]

Any opening of access to the MSO markets under these negotiations will be on a reciprocal basis. The implications of such opening will almost certainly be to facilitate cross-border merger and integration, as has been the case in the telecommunications industry. Therefore, some possibility of decreased competition in the MSO world might occur perhaps plausibly to a level where one firm has 30% to 50% of the world market. The tendency will also be to open an increasing (but not total) share of national MSO markets to access by foreign content production firms. This could strengthen the market shares of the current leading content ex-

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[75] *See* WTO Doc. S/CSS/W/21 (18 December 2000). Although this was submitted during the Clinton administration, it is still part of the U.S. negotiating position and was incorporated in the current U.S. negotiating proposal. *See U.S. Department of State, USTR Proposes in WTO Negotiations Transparency in Services Regulation, available at* http://usinfo.state.gov/topical/econ/wto/02070102.htm (Jul. 1, 2002).

[76] *See* Office of the United States Trade Representative, *U.S. Proposals for Liberalizing Trade in Services,* Executive Summary, July 1, 2002, *available at* http://www.ustr.gov (last visited Mar. 1, 2004).

[77] World Trade Organization, *Communication from Brazil,* WTO Doc. S/CSS/W/99 (Jul. 9, 2001).

[78] World Trade Organization, *Communication from Brazil,* WTO Doc. S/CSS/W/72 (May 4, 2001).

porter, for example the United States, but it could also open up the possibility for new entrants to combine a viewership from several nations and therefore obtain a niche.

Whether these trends will affect the content market and the free speech goals defined above depends on the details of the vertical arrangements that the MSOs and media firms are permitted to negotiate. The Swiss position is an obvious invitation to negotiate about such arrangements. There is a precedent in the Telecommunications Services Agreement.[79] Although this agreement is not applicable to media-type video services, it includes a "reference paper," containing a set of regulatory principles. These principles, which may plausibly be adapted to the audiovisual area, include commitments that "[a]ppropriate measures shall be taken for the purpose of preventing suppliers who, alone or together, are a major supplier from engaging in or continuing anti-competitive practices," defined to include "anti-competitive cross-subsidization."[80]

C. *Free Speech Principles*

Economic approaches are integrated with free speech concerns at the domestic level in a variety of ways, particularly because it avoids content regulation, through structuring the industry to achieve a diversity of perspectives. At the international level, the integration of these speech concerns with economic concerns is clearly more difficult. Certainly, the maintenance of a favorable industrial structure is positive (and is strongly favored if such a structure is present in several of the major regulatory groups such as the United States and Europe). However, the new possibility is that a government will prohibit access to particular programs. Such a prohibition naturally affects the freedom of its citizens to obtain access to information. It also affects the global economics, to the extent that a video channel is excluded from a specific nation, because it loses economic potential and, at the margin, will not be available to the rest of us as well.

The formal international law balance, which is reflected in the international human rights agreements, protects freedom of speech, albeit with restrictions to protect intellectual property interests, restrictions to protect reputation (libel, slander, and rights of reply), restrictions against incitement, and restrictions on pornography. These restrictions are typically defined to be compatible

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[79] *See* World Trade Organization, *Agreement on Telecommunications Services (Fourth Protocol to General Agreement on Trade in Services)*, 36 I.L.M. 344 (Feb. 15, 1997).
[80] *Id.* at 367.

with fundamental principles of freedom. For example, the International Covenant on Civil and Political Rights, which a large portion of the world's nations, including the United States, are parties, states:

> Article 19: (1) Everyone shall have the right to hold opinions without interference.
>
> (2) Everyone shall have the right to freedom of expression; this right shall include freedom to seek, receive, and impart information and ideas of all kinds, regardless of frontiers, either orally, in writing, in print, in the form of art, or through any other media of his choice.
>
> (3) The exercise of the rights provided for in paragraph 2 of this article carries with it special duties and responsibilities. It may therefore be subject to certain restrictions, but these shall only be such as are provided by law and are necessary: (a) For respect of the rights or reputations or others; (b) For the protection of national security or of public order, or of public health or morals.[81]

Many nations have not lived up to this Convention.

It is particularly notable that the Convention provides for the right to receive information across borders, a position strongly contested in practice by a number of nations, including parties to the international human rights treaties who have completely rejected the concept of an obligation to permit cross-border flows of information or cross-border access to information. The legal dispute over a nation's right to control incoming information arose in the context of the regulation of direct broadcast satellites and came to a head during the 1960s, with a non-resolution in 1982. The Gen-

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[81] G. A. Res. 2200, entered into force on March 23, 1996. Greater detail is contained in the European Convention for the Protection of Human Rights and Fundamental Freedoms, 213 U.N.T.S. 221. Article 10 states:

> 1. Everyone has the right to freedom of expression. This right shall include freedom to hold opinions and to receive and impart information and ideas without interference by public authority and regardless of frontiers. This Article shall not prevent States from requiring the licensing of broadcasting, television or cinema enterprises.
> 2. The exercise of these freedoms, since it carries with it duties and responsibilities, may be subject to such formalities, conditions, restrictions or penalties as are prescribed by law and are necessary in a democratic society, in the interests of national security, territorial integrity or public safety, for the prevention of disorder or crime, for the protection of health or morals, for the protection of the reputation or rights of others, for preventing the disclosure of information received in confidence, or for maintaining the authority and impartiality of the judiciary.

Id.

eral Assembly passed a resolution[82] over the opposition of the United States and the other nations likely to create such systems that carefully avoided resolving the dispute between those who favored national consent to control access of citizens to information and those who favored international freedom of speech. The heart of the compromise is suggested by Articles 13 and 14 of the Principles:

> 13. A State which intends to establish or authorize the establishment of an international direct television broadcasting satellite service shall without delay notify the proposed receiving State or States of such intention and shall promptly enter into consultation with any of those States which so requests.
> 14. An international direct television broadcasting satellite service shall only be established after the conditions set forth in paragraph 13 above have been met and on the basis of agreements and/or arrangements in conformity with the relevant instruments of the International Telecommunications Union and in accordance with these principles.

This is clearly intended to suggest that the recipient nation's prior consent is needed while leaving open an interpretation under which broadcasts can begin as long as negotiations were attempted and the ITU rules are conformed with (presumably meaning the rules designed to prevent radio signal interference).

The trend is probably toward global acceptance of the idea that citizens should have access to information regardless of their government's desires. As a formal legal matter, this is certainly the implication of the Covenant, which would override even an inconsistent General Assembly resolution. Also, it seems to be in the broader political air, considering, for example, attitudes toward the Internet and the significant recent increases in freedom in the former Soviet bloc. Moreover, the European Union has, in its common market for video programming, under its Television Without Frontiers program, effectively eliminated the right of a national government to reject satellite broadcasts.[83] This directive designs a system under which a source nation is responsible for ensuring that

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[82] *See Principles Governing the Use by States of Artificial Earth Satellites for International Direct Television Broadcasting*, GA Res. 37/92, (Dec. 10, 1982), UN Doc. A/Res/37/92.

[83] *See* Council Directive 89/552/EEC of 3 October 1989 on the Coordination of Certain Provisions Laid Down by Law, Regulation or Administrative Action in Member States Concerning the Pursuit of Television Broadcasting Activities, 1989 O.J. (L298) 35, as Amended by Directive Pursuit 97/36/EEC of the European Parliament and of the Council of 30 June 1997 Amending Council Directive 89/552/EEC on the Coordination of Certain Provisions Laid Down by Law, Regulation or Administrative Action in Member States Concerning the Pursuit of Television Broadcasting Activities, 1997 O.J. (L 202) 60.

broadcasting comports with its own laws, while nations in which the signal is received must normally not restrict retransmission of that signal.[84] This has been interpreted as overriding Belgian legislation to create a monopoly on the broadcast of television and carrying of advertising in Flemish.[85] It has affirmatively required the Belgians to ensure broadcast in Flemish from the U.K., seek Flemish advertising through an office in Belgium and not to prohibit cable carriage of a British based station.[86]

The most important implication of this analysis is that a legal basis exists for provisions designed to prevent national governments from imposing access restrictions. This may sound utopian, but it rests on an international human rights position and it legitimizes the consideration of speech concerns in designing international systems that affect video programming.

V. Competition and Regulatory Implications

This analysis suggests that a move toward deregulation is not necessarily wise. There are important advantages to size and integration that are unique to this industry, and which have significant consequences to the terms of entry and therefore to the citizen's access to information.

A. *Horizontal Issues in the Content Industry*

The key goal of regulation and anti-trust action in the content industry is to maintain the opportunity of entry for new sources and channels that could reach a large number of people. Estimating the availability of entry is a matter of judgment, but it is a serious and reasonable concern with mergers in the content industry that a small number of entities will control access to video information and that those entities will exercise this control in a way antithetical to public needs for information. This could be for the sake

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[84] *Id.*

[85] *See Re* Flemish TV Advertising: The Community v. Belgium, [1997] E.C.R., [1997] 5 C.M.L.R. 718.

[86] *See* VT4 Ltd. v. Vlaamse Gemeenschap, Case C-56/96, [1997] E.C.R., [1997] 3 C.M.L.R. 1225. There are exceptions to this duty to carry, involving "pornography or gratuitous violence. . . which might seriously impair the physical, mental or moral development of minors. . . [and] incitement to hatred on grounds of race, sex, religion or nationality." Council Directive 89/552/EEC of 3 October 1989 on the Coordination of Certain Provisions Laid Down by Law, Regulation or Administrative Action in Member States Concerning the Pursuit of Television Broadcasting Activities, 1989 O.J. (L298) 36, as Amended by Directive Pursuit 97/36/EEC of the European Parliament and of the Council of 30 June 1997 Amending Council Directive 89/552/EEC on the Coordination of Certain Provisions Laid Down by Law, Regulation or Administrative Action in Member States Concerning the Pursuit of Television Broadcasting Activities, 1997 O.J. (L 202) 60.

of protecting the particular firm's economic position (as through downplaying of stories that criticize the firm or of stories offensive to important countries in which the firm operates). As one European analyst put it, in traditional economic analysis, we are concerned with the abuse of a dominant position; in this context, because of the political values of communications, we should be concerned about the existence of a dominant position.[87]

The analysis of this article suggests that there is little risk that a merger will lead directly to integration of a substantial part of the content market,[88] except in very specific submarkets, and still less that a merger will lead to power sufficient to affect prices to the consumer.[89] Nevertheless, from a diversity perspective (or an economic perspective with respect to the relevant advertising market), it seems reasonable to avoid mergers that significantly reduce concentration in a geographical or interest-defined submarket (e.g. a merger that significantly reduces the number of children's channels or news channels). Thus, there is a reasonable economic and free speech basis for cross-ownership restrictions that take into account sub-market concentration on the basis of a Herfindahl index or similar measure of concentration. A recent European antitrust example is the *Bertelsmann/Kirch/Première* merger, which was struck down because of its effect in the German pay-TV market.[90] Rules

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[87] Jens Cavallin, *European Policies and Regulations on Media Concentration*, INT'L. J. COMM. L. & POL'Y, *available at* http://www.ijclp.org/1_1998/ijclp_webdoc_3_1_1998.html (Feb. 11, 1998). I must recognize that there is a broad similarity between this argument and that raised by the old proposal for a New International Information Order, a proposal—absolutely and properly rejected by the United States—to use government power (fundamentally in the form of censorship) to compensate for the fact that many developing-world media and information sources were controlled by developed world corporations. This debate led the United States and the United Kingdom to leave the United Nations Educational Scientific and Cultural Organization (UNESCO) in 1984. In 2002, President Bush announced that the United States would rejoin. White House Fact Sheet: Unites States Rejoins Unesco, Sept 12, 2002. The most important issue, however, is not whether governmental (or international) power is used to affect the structure of the media – such use is unavoidable. Rather the issue is how that power is used – we prefer structural regulation to content regulation, we prefer ways to encourage the publication of unpopular views to ways to discourage the publication of dominant views, etc. In order to define a structure that serves broad first amendment/freedom of speech/diversity/market place of ideas values, we intervene in ways that can sometimes be read as offending the same values. The problem is how to structure that intervention wisely.

[88] Thus, the analysis provides little support for the FCC's rule requiring that no entity may hold television stations reaching more than 35% of the national market, a rule struck down in Fox Television Stations v. FCC, 280 F.3d 1027 (D.C. Cir. 2002).

[89] Nevertheless, pricing issues are at the heart of a current UK Office of Fair Trading investigation of BskyB. *See* Ashling O'Connor, *BskyB faces fines and lawsuits from rivals*, THE FINANCIAL TIMES, Dec. 18, 2001, at 1. The investigation was concluded on December 17, 2002, with a determination that BSkyB had a dominant market position but was not in breach of competition law. *See* Press Release, *supra* note 44.

[90] *See Bertelsmann/Kirch/Premier*, Case IV/M.993, Commission Decision of May 27, 1998, O.J. 1999 L53/1.

exist in the United States, as a regulatory example, under which newspapers may not generally own television stations in the markets that they serve.[91] Even though they are under attack, they seem reasonable – and probably wise – so long as they are tied to a reasonable degree of concentration in the particular submarket. Save in a few cases of international mergers among content firms carrying competing interest-based channels, this will normally be a matter of national law rather than international arrangement.

Second, the analysis of monopoly power has to take into account both vertical relationships and integration. As the analysis here demonstrates, a content firm that controls a significant portion of the distribution world is in a much stronger competitive position than one without such assets. It is particularly clear that such vertical power can be used to deter entry of the type desired to achieve diversity. The analysis of market power must take this into account; and it is quite clear that the relevant control includes control of foreign distribution channels as well as of domestic channels. Hence, mergers among content firms that have significant distribution holdings should be subject to much more severe control than mergers among content firms without such holdings.

B. *Horizontal Issues in the MSO Industry*

At the MSO level, the consumer has two direct concerns. One is price – is the risk of effective monopoly so strong that the distributor can, on behalf of itself or of content providers, exact too high a price? The other is control – what is the risk that the distributor becomes a controller of access, favoring, for example, one political perspective or one group of content providers? But there is also a strong indirect concern – as argued in this paper, market power at the distribution level can, depending on the vertical arrangements, be translated into power in the content market, and it is wise to restrict that power.

First, competition can help with the consumer's direct concerns. Thus, the United States Telecommunications Act of 1996[92]

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[91] This rule has come under criticism as a result of the growth of increased access to increased numbers of channels, but it was upheld in 1998. *See* Tribune Co. v. FCC, 133 F.3d 61 (D.C. Cir. 1998). The parallel rules preventing common ownership of a cable system and a broadcast system in the same market and preventing common ownership of television stations in any market with less than eight separate voices were struck down in *Fox Television Stations Inc. v. FCC*, 280 F.3d 1027, and *Sinclair Broad. Group, Inc. v. FCC*, 284 F.3d 148 (D.C. Cir. 2002), respectively. These decisions were all decided on administrative law and statutory interpretation grounds; it seems fairly clear that such regulations could survive a Constitutional attack. *See, e.g.*, FCC v. Nat'l. Citizens Comm. For Broad., 436 U.S. 775 (1978).

[92] Pub. L. No. 104-104, 110 Stat. 56 (1966).

is premised on the assumptions that cable, the telephone line, the Internet, and satellite systems can compete, and that that competition can be a source of freedom and competitive pricing. Yet, because of the consumer's difficulty in changing from one technology to another, the competition is weak, and may sometimes have to be supplemented by price regulation. This was, in fact, the point of the Cable Television Consumer Protection and Competition Act of 1992.[93]

Second, the consumer's content concern may be more significant and is certainly more difficult. Unless the consumer has a choice of distributors, the consumer is entirely at the mercy of the MSOs choice of content. In the United States, this choice is restricted by the requirements on the cable operator to carry local channels.[94] Moreover, it is always restricted by the economic pressures on the MSO to carry channels that will gain a large viewership. And, of course, controlling that choice causes concern about government interference with free speech.[95] But there are already options such as use of an essential facilities doctrine in private litigation or use of a common carrier doctrine in the regulatory context.[96] In Europe, certain events are designated as being of public interest and must be carried.[97] Other approaches worth considering include giving viewers a way to petition for access to specific channels, giving channel owners a way to request access on "most favored nation" type terms defined by comparison with the channels already carried, or simply creating transparency in the channel selection process as by requiring all prices and terms to be made public. This access issue is more a problem in some countries than in others, and its economic aspects will become less complex as the number of channels that can be delivered to a home grows.

Third, horizontal integration at the MSO level can lead to a

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[93] Pub. L. No. 98-549, 98 Stat. 2779 (1992) (upheld in Time Warner v. FCC, 93 F.3d 957 (D.C. Cir. 1996)).

[94] *See supra* note 1.

[95] Note that, in the United States, we were willing to face this issue in the context of allocating broadcast licenses, where there was an issue of allocating limited public spectrum. The Constitutional basis for intervening is much more narrow in today's market which relies less on spectral allocations.

[96] *See* OWEN & WILDMAN, *supra* note 25, at 236-38.

[97] *See* Council Directive 89/552/EEC of 3 October 1989 on the Coordination of Certain Provisions Laid Down by Law, Regulation or Administrative Action in Member States Concerning the Pursuit of Television Broadcasting Activities, 1989 O.J. (L298) 23, at Art. 3a, as Amended by Directive Pursuit 97/36/EEC of the European Parliament and of the Council of 30 June 1997 Amending Council Directive 89/552/EEC on the Coordination of Certain Provisions Laid Down by Law, Regulation or Administrative Action in Member States Concerning the Pursuit of Television Broadcasting Activities, 1997 O.J. (L 202) 60. These rules were applied with respect to World Cup coverage in *R. v. Independent Television Commission*, [2001] 3 C.M.L.R. 26 (H. of L.).

buildup of market power in a way that may decrease diversity at the content production level. According to the model of this paper, this can be an issue if particular distributors hold a large share of the market and have a way to exercise their power at the content production level, either through integration or through contract terms. Hence, the analysis of a merger at this level must take into account the total market power of the firms at the distribution level, together with the presence or not of preexisting vertical integration and the character of any agreements between content-providing firms and the MSO firms whose merger is being considered.[98]

C. *The Vertical Issues*

First, it is the vertical relationships between content firms and distribution firms that enable a content producer to gain the leverage needed to deprive a competitor or a potential entrant from a significant portion of the market – and therefore significantly reduce the potential of entry. Indeed, the above analysis strongly suggests that vertical integration between program creators and MSOs is unwise (save perhaps in cases in which each has a very small market share). Divestiture at this point would, however, be extremely difficult, perhaps even politically impossible. Nevertheless, it is essential to forestall future vertical integration. There has already been some effort in this direction, as in the Federal Trade Commission's requirement of certain vertical divestitures as part of the Time Warner Turner merger.[99] Although the FCC has issued a rule requiring that cable systems reserve 60% of their channel capacity for non-affiliated programs, this rule has been struck down and the FCC has no restrictions on vertical integration that would prevent control of an MSO by any other kind of entity.[100]

Second, whether or not mergers have taken place, it is essen-

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[98] This issue was covered by the FCC's rule that no single cable operator should have more than 30% of the market, a rule struck down by the D.C. Circuit in *Time Warner Entertainment v. FCC*, 240 F.3d 1126, 1129 (2001). The analysis here differs from that rejected by the court. The FCC had estimated that a new video entrant would need access to 40 % of the market to be viable, and conceived of the possibility that two cable operators might collude to prevent access by the new entrant. It followed that no cable operator should have more than 30% of the market. The D.C. Circuit accepted the 40% logic (at least *arguendo*) but rejected the collusion logic. *See id.* at 1132. The analysis of the model is rather that existing content providers gain a group of network benefits from access to market shares held by large cable operators, and that these network benefits strengthen their competitive position against new entrants. The force of the argument depends on the market share, on the vertical arrangements, and on the extent to which the entrant seeks the same audience as the incumbents.

[99] *See In re* Time Warner, Inc., 123 F.T.C. 171 (1997).

[100] *See Time Warner Entertainment*, 240 F.3d. at 1139.

tial to impose appropriate antitrust rules on vertical agreements in order to ensure that such agreements do not create unnecessary barriers to entry in the content production market. The obvious antitrust requirements, based on the competition analysis above, are to restrict exclusives lasting longer than is needed for basic planning, to prohibit block booking, and, most sharply, to prohibit agreements prohibiting the carriage of competing programs. At this point, there are rules prohibiting "unfair competition and discriminatory practices by cable operators and certain vertically integrated programmers," and restricting exclusive distribution contracts between vertically integrated cable operators and programmers.[101]

D. *International Principles*

The economics – and the speech issues as well – are thoroughly international. Much of what has just been discussed can be resolved at the national level – but not all. And the most likely forum of negotiations is a special agreement, perhaps a Video Code, negotiated under the auspices of the WTO Services Code.[102] What should be included in such a code?

First, and this is politically inevitable as suggested above, is to provide access for foreign firms to participate in national markets, as by creating or purchasing media providers or MSOs. This is the operation of an international competitive market and can provide efficiencies. But, according to the analysis of this paper, it is essential that these commitments provide exceptions to maintain competition. There are global interests in maintaining competition at both the content production and the MSO levels. Since that competition may be undercut by foreign purchases of local firms, a nation should be permitted to (or better, required to) take into account such competitive factors when approving or disapproving a particular merger. Moreover, because of the importance of the vertical issues as identified here, nations should be allowed to (or better, required to) prohibit purchase of a local MSO by a foreign content provider, and vice-versa. It may be wise to go even further, and restrict domestic mergers in order to enable large national firms to compete with large foreign firms.

Second, the most important form of access is access of content providers to MSOs, and this access should be open. This is the

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[101] 47 U.S.C. § 548 (2003); 47 C.F.R. §§ 76.1000-76.1003 (2003).

[102] Although it is possible to achieve many of the same results through parallel antitrust action, why not take advantage of the fact that WTO negotiations are going in the area and attempt to shape them to achieve both competition and freedom of expression goals?

openness that matters, for this is the openness that brings freedom of speech and brings the opportunity for diversity through greater market openness through the entry of new content providers.

Third, a limited share of reserved local content channels is quite appropriate, both for encouraging local cultural diversity and for protecting against the market power of content providers who already reach large markets. As an economic matter, these restrictions bring both a cost and a benefit in achieving diversity of content production. As a speech diversity matter, they may be quite important. Hence, it seems unreasonable to allow them to be completely barred by a free trade analysis that is more persuasive in situations where the industrial structure is more likely to lead to equation of marginal cost and marginal revenue. Moreover, in an industry so marked by externalities and by internal cross-subsidies, it seems reasonable for nations to be free to subsidize their content industries and possibly even their distribution industries. Exclusivity in a large market, as may be available through contract or intellectual property rights, permits recovery of content development costs from national viewers, and therefore has much the same economic effect as a subsidy.[103]

Fourth, the terms of vertical deals between content providers and MSOs must be controlled – this is the central issue from a competition perspective. Ideally, one would prohibit vertical integration, for example, to prohibit local MSOs from being integrated with program creators, and undo existing vertical integration. Similar to the national level, the issue is one of prohibiting further vertical integration and of restricting the terms of vertical deals so as to minimize the ability to achieve, by contract, what might be achieved by integration. The reasonable prohibitions would be the same as those at the national level, like those on long term exclusives (at least when either party had significant market power), on block booking, and, most of all, on restrictions that prevent an MSO from carrying competing programs. These provisions are particularly important because of the risk that firms will otherwise seek such provisions in order to have a chance of entry against firms that already have the benefit of such exclusive rights.[104]

Fifth, and certainly most problematic, there should be freedom of speech provisions. The analysis above shows many examples in which governmental authorities have used their power to

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[103] *See* Barton, *supra* note 54, at 497 (applying this logic to international intellectual property regimes).

[104] *See, e.g.*, *TPS*, Case IV/36.237, Commission Decision of March 3, 1999, O.J. 1999 L90.

control the flow of information — and the emerging interlocked structure of the industry facilitates this control, including extension of restrictions beyond the borders of the nation seeking to impose the restriction. These are not simply harmful to the citizens of the nation involved; they are also economically harmful to all because of their impact on the feasibility of new and dissenting content providers, and they are politically harmful to all because of their effect on the flow of information. If the viewer is to have the real benefit of diversity, the viewer should be entitled to watch channels of general interest, even though the national government might dislike it.

This is difficult to implement, as already recognized in the domestic context. Privately-owned systems, which will follow the profit-maximizing desires of their viewers, will almost certainly carry some and reject some politically important programs as a result, and it is hard to define a reasonable system for encouraging freedom of speech for such a system. It will be even harder to ensure carriage of programming on national publicly owned systems. One international approach is simply to prohibit government restrictions on channel access (presumably with appropriate exceptions for obscenity, etc.) – this would provide a defense for an MSO that wished to carry a channel. Governments in third nations (presumably those whose content producers were affected) could then use traditional WTO dispute settlement approaches to contest channel restrictions suspected as deriving from pressures from the host government.

The strongest political counterargument to including such a provision is that it makes an audiovisual agreement unacceptable to a number of governments, and therefore slows the rate at which infrastructure grows in those nations and at which commitments can be made to open other less controversial aspects of the video market (and regulate vertical relations). Nevertheless, it may be useful to create a zone of freedom to provide an example for others. As Western Europe did vis-à-vis Eastern Europe, the holdouts will sooner or later be moved domestically to enter the zone of freedom. More broadly, it would be politically unwise to deal internationally with issues that are so sensitive from a freedom of speech perspective without recognizing the need to support that freedom. As the analysis here indicates, the speech and economic concerns are linked internationally, just as they are domestically. WTO panels might as well take on freedom of speech issues along with the intellectual property and administrative law issues that they already handle.