18 Media sjc 67-70 22/9/04 1:46 pm Page 67

Antitrust developments in the media and entertainment industries

Kenneth R Logan, Peter E Kazanoff, and Julissa Reynoso
Simpson Thacher & Bartlett LLP

The media and entertainment industries continue to face antitrust issues as industry participants react to various pressures resulting from technological changes, especially the distribution power of the Internet, as well as the erosion of profits due to old-fashioned head-on competition. As media and entertainment companies (and their trade associations) attempt to solve their business problems, both antitrust enforcement agencies and private plaintiffs have raised concerns. Some of the solutions implemented by industry participants appear to enhance competition; others continue to engender closer scrutiny.

Sony BMG joint venture

Since Universal's acquisition of PolyGram in 1998, five 'major' music companies (Universal Music Group, Sony Music, Warner Music, BMG, and EMI) have controlled over 80 per cent of the world's music content. Subsequent efforts by the majors to consolidate their music operations have met with regulatory resistance, both formally (Warner Music and EMI abandoned a notified combination in 2000 after the European Commission filed a Statement of Objections)[1] and informally (BMG and EMI abandoned merger discussions in 2001 in light of opposition in both Europe and the US).[2] Against this background, Sony Corporation of America (parent company of Sony Music) and Bertelsmann AG (parent company of BMG) announced in late 2003 their intention to create Sony BMG, a joint venture combining their recorded music businesses. The 50-50 joint venture did not include the parent companies' music publishing, physical distribution and manufacturing operations.

Because Sony BMG was structured as a joint venture and was announced prior to recent amendments to the Hart-Scott-Rodino Act, the parties were not required to notify the transaction to US antitrust enforcement agencies.[3] The proposed transaction, however, met with substantial resistance at the European Commission. In February 2004, the Commission opened an 'in-depth investigation' (ie, phase II proceedings)[4] into the joint venture and issued a Statement of Objections which alleged that the five majors already exercised 'collective dominance' in recorded music which would be strengthened by further consolidation to four majors. However, in July 2004, the Commission announced that it would not oppose the transaction.[5] The Commission stated that its analysis of 'price data' and 'third-party submissions' revealed that there was "a deficit in the transparency of the market" and the evidence was insufficient to demonstrate that "coordinated pricing behaviour existed in the past and that a reduction from five to four major recording companies would not yet create a collectively held dominant position".[6] The Commission further announced that it had examined the transaction's impact on the "emerging market for online music licenses as" well as online music distribution but found no "serious competition problems".[7] The parties completed the creation of Sony BMG in August 2004.

While not mentioned in its public statements, two factors almost certainly influenced the Commission's decision not to oppose Sony BMG, a decision that differs significantly from the Commission's position on prior consolidation efforts in the recorded music industry. First, since the Commission's opposition to *Warner Music/EMI* in 2000, the Internet-based piracy of music content has continued to increase at an exponential rate and efforts by the majors to sell their music content online have been, at best, only marginally successful. Thus, any efforts to increase prices, according to the parties, would be constrained by the availability of 'free' music via pirates.

Second, and perhaps more importantly, the European Court of First Instance has chastised the Commission on more than one occasion since 2000 (most notably in its *Airtours* decision) for a failure to develop sufficient evidence to support collective dominance allegations. The decision not to oppose Sony BMG may signal the Commission's concern about its ability to meet the higher standard of proof now required to prove collective dominance. Indeed, the Commission's forthcoming decision in *Oracle/PeopleSoft* may shed further light on this issue.

Developments in multichannel video programming distribution

Video programming (eg, broadcast television, cable programming, etc), and the method by which that programming is delivered to consumers, continues to raise important and complex antitrust issues in numerous contexts, including both merger review and private litigation.

Merger developments

In October 2002, the DoJ sued to enjoin EchoStar Communications' bid to acquire DirecTV from Hughes Electronics and its parent, General Motors.[8] Echostar and DirecTV were, and continue to be, the only two national providers of direct broadcast satellite ('DBS') services. These two DBS providers and rival local cable operators are the only significant sources of multichannel video programming distribution ('MVPD') in the US. The DoJ concluded that the transaction would be a merger to monopoly in those areas of the country not served by cable operators and would lead to a three-to-two merger in cable areas, seriously threatening price competition and innovation. The Federal Communications Commission ('FCC') also refused to approve the merger after concluding that the likely harm to competition outweighed any public interest benefits.[9] Following the DoJ's decision to file suit, the parties abandoned the transaction.

In April 2003, News Corporation, the owner of the Fox Entertainment Group (including the Fox television network) and a significant DBS operator outside the US, announced that it had reached an agreement to acquire control of DirecTV from Hughes and General Motors. Even though the transaction did not involve a combination of horizontal competitors, it did raise certain vertical issues that were the subject of a 'Second Request' issued by the DoJ in June 2003. The

Second Request, and a parallel investigation conducted by the FCC, focused on News Corporation's ability and potential incentive to withhold (or threaten to withhold to exact higher licence fees) programming content (principally regional sports programming and the right to retransmit the Fox television network) from cable television and DBS providers (ie, EchoStar) that compete with DirecTV.

In December 2003, the DoJ announced that it would not challenge the transaction in light of conditions imposed by the FCC in connection with its approval of the transfer of the DirecTV licences. Among the conditions imposed by the FCC were: (i) the creation of a commercial arbitration mechanism that an MVPD can invoke to resolve a dispute over the terms upon which it will carry regional sports programming controlled by News. Corporation, and (ii) the creation of a commercial arbitration provision that an MVPD can invoke to resolve a dispute over the terms upon which it will retransmit local Fox stations.[10] The FCC's Opinion and Order makes clear that it believed these conditions were necessary because the vertical relationship between the Fox Network and DirecTV could create incentives for News Corporation to withhold, or threaten to withhold, programming from rival MVPDs, an incentive that would not exist without the vertical relationship.[11]

Private litigation

In recent years, several high profile contractual disputes between MVPDs and content providers (eg, the YES network and Cablevision) have resulted in certain MVPD subscribers losing access to highly popular programming for extended periods of time. One particularly contentious area concerns negotiations for retransmission rights for local broadcast stations of the major networks (eg, CBS, NBC, ABC, Fox) and independent broadcast stations. Pursuant to legislation and FCC rules adopted in the 1990s, the owners of broadcast stations must negotiate in 'good faith' with MVPDs concerning the terms upon which local network television signals are retransmitted to DBS and cable subscribers. When the FCC's retransmission right regime was created, MVPDs refused to pay cash for retransmission rights. Instead, MVPDs paid for retransmission rights 'in kind' by agreeing to carry cable channels that were affiliated with the owner of the local broadcast network.[12] These arrangements commonly worked to the benefit of both broadcast networks and MVPDs.

In January 2004, EchoStar sought a temporary restraining order and preliminary injunction against Viacom (the owner of both CBS and leading cable programming networks such as MTV, Nickelodeon, and BET) alleging that Viacom was illegally 'tying' CBS retransmission rights to EchoStar's carriage of affiliated cable programming.[13] The suit, which was brought in the Northern District of California, asserted that Viacom's conduct constituted a per se violation of the Sherman Act. The court granted EchoStar's request for a temporary restraining order, which ensured that EchoStar subscribers would have access to CBS's broadcast of the Super Bowl, and invited briefing as to whether a preliminary injunction should issue. After oral argument, the court denied the preliminary injunction. The court did not rule on the merits of EchoStar's antitrust claims but expressed scepticism as to whether EchoStar could show irreparable harm. Shortly after the temporary restraining order was lifted, EchoStar subscribers lost access to Viacom channels for several days until the parties negotiated a settlement of the litigation and a contract to replace the agreement that had expired at the end of 2003.

While the litigation between EchoStar and Viacom was resolved, it can be expected that similar disputes will continue to arise between MVPDs and programmers. The contractual stand-offs have large financial consequences. These disputes are likely to involve both consideration of FCC rules and decisions, as well as the application of more familiar antitrust principles such as tying claims. Future litigants in this area should carefully consider the Supreme Court's *Trinko* decision,[14] which was released during the pendency of the *EchoStar/Viacom* litigation. While *Trinko* concerns the telecommunications industry (rather than MVPDs) and a monopoly leveraging claim (rather than a tying claim), the decision does unambiguously instruct courts to be cautious in permitting parties to pursue antitrust claims (especially per se claims) in heavily regulated industries such as cable programming and broadcasting where government regulations address the same conduct challenged as an antitrust violation.

DoJ clears online movie venture

Faced with an online piracy threat similar to that confronting the music industry, five major movie studios—Sony (Columbia-TriStar Pictures), Paramount, MGM, Warner Brothers and Universal—formed a joint venture in August 2001 to distribute films over the Internet on an on-demand basis. The joint venture (ultimately known as Movielink) is owned equally by its five studio partners, which, according to the DoJ, account for 50 per cent of domestic box office revenues. Under the terms of Movielink agreements, each studio separately determines the pricing and release dates for its own films and the films are provided to Movielink on a non-exclusive basis. Movielink began delivering movies over the Internet in November 2002.[15]

In June 2004, the DoJ cleared the venture and issued the following statement: "The Division's substantial investigation of Movielink does not indicate that the formation of this joint venture by five of the major movie studies harmed competition or consumers of the movies. The investigation focused on whether formation of the joint venture facilitated collusion among the studies or decreased their incentives to license movie content to competing video-on-demand (VOD) providers. The Division considered several theories of competitive harm but ultimately determined that the evidence does not support a conclusion that the structure of the joint venture increased prices or otherwise reduced competition in the retail markets in which Movielink competes..."[16] It is likely that the each studio's control over pricing and release dates, coupled with their non-exclusive arrangements with Movielink, were important factors in the DoJ's decision to close its investigation.

Movie studios attempt to limit distribution of screeners prior to Academy Awards

In September 2003, the Motion Picture Association of America ('MPAA') announced that its member companies (the major movie studios) would not send out promotional DVDs of films (called 'screeners') to industry awards groups in an effort to combat film piracy that the MPAA had traced back in prior years to the distribution of screeners. In October 2003, the MPAA modified the policy to permit distribution of screeners to Academy Award voters who agreed in writing to maintain control over their film copies to prevent their use as illegal copies but otherwise continued its screener ban.

In November 2003, organisations representing leading independent film-makers in Los Angeles and New York filed a suit in the Southern District of New York alleging that the MPAA's 'partial screener ban' severely disadvantaged independent and specialty films that depend on wide distribution of screeners to a broad array of awards groups to promote their films and secure financing for current and future projects.[17] The plaintiffs argued, inter alia, that the partial screener ban was an agreement among horizontal competitors (ie, the movie studios) to limit competition in the promotion of independent films and therefore violated Section 1 of the Sherman Act under either per se or rule of reason analysis. In December 2003, the court, observing that reaching such an agreement under the auspices of a trade association did not immunise the agreement, rejected the arguments that the screener ban was an appropriate and necessary industry-wide

18 Media sjc 67-70 22/9/04 1:46 pm Page 69

response to the threat of piracy and, further, that independent film-makers could not show antitrust injury. The court preliminarily enjoined the MPAA from taking any action to implement the partial screener ban that was announced in October 2003. The matter was settled in March 2004 and the pending litigation was dismissed.

File-sharing services

In recent years, music and film companies have brought numerous copyright infringement actions against various file-sharing services and distributors of file-sharing software that allow users to share electronic files, including copyrighted materials. The most notable of these actions was a copyright infringement action brought against Napster in the Northern District of California that ultimately resulted in the shuttering of the highly popular music file-sharing service. The *Napster* plaintiffs successfully argued that because Napster maintained a 'central indexing system' of the songs available on each individual user's computer, Napster was secondarily liable for copyright violations by its users.[18]

A second generation of file-sharing software does not rely on the type of 'central indexing system' that Napster used. Instead, this software facilitates file sharing by reading 'indexes' that reside on the users' computers rather than a central server. In 2001, a group of movie studios, music companies, songwriters, and music publishers brought copyright infringement claims in the Central District of California against several leading second generation file sharing software providers, including Grokster, Streamcast, and Kazaa. In April 2003, the court granted summary judgment in favour of the defendants.[19] The court found that, unlike Napster, second-generation file-sharing software providers have limited, if any, control over how their software is used after it is released to the public. In the court's view, this finding, and the fact that the software could be used for legitimate purposes, insulated the defendants from copyright infringement liability. In August 2004, the Court of Appeals for the Ninth Circuit affirmed the District Court and rejected the invitation from the copyright owners to expand copyright law to cover the activities of decentralised file-sharing software providers noting that "we live in a quicksilver technological environment with courts ill-suited to fix the flow of internet innovation".[20]

In the Grokster litigation, Sharman Networks, one of the defendants, brought antitrust and copyright misuse counterclaims against the music and film companies. In essence, Sharman alleged that the plaintiffs controlled as much as 85 per cent of the copyrighted music and films and had refused to license that material to Sharman thereby preventing Sharman from competing effectively in the distribution of music and films. As a remedy, Sharman sought damages and invalidation of the plaintiffs' copyrights under the judge-made theory of copyright misuse. In July 2003, these counterclaims were dismissed.[21] The court, however, found that Sharman did not have standing to assert the counterclaims and therefore did not rule on the merits of those counterclaims.

Inevitably, as the music and film content providers try to protect their works under copyright laws, their efforts will spark copyright misuse and antitrust claims both from the alleged pirates and, importantly, from developers of technology who say that the reason they are not able to be successful is that there is a conspiracy among content owners. Going forward, music and film content providers should proceed with caution when reacting to piracy since reacting without care can create additional problems, and 'industry' reactions to new technologies can invite antitrust scrutiny by the government and by private plaintiffs.

EC pay-TV investigation

The European Commission has been reviewing aspects of the pay-TV licensing activities of US major studios for several years.[22] Currently, the Commission appears to be concerned that certain most-favoured-nations ('MFN') clauses included in some of the contracts between the studios and European pay-TV operators have artificially raised the price of first-run US films, thereby impeding entry of competitive pay-TV operators. While this is an issue of first impression in Europe, there is a significant body of US law on this issue. In so-called 'competitor exclusion cases', the use of MFN clauses by dominant buyers have been held to exclude entry by actual or potential horizontal rivals to such buyers by restricting their access to lower cost inputs. In such cases, the MFN clause operates to the benefit of the dominant buyer, creating a powerful incentive against seller discounting and thereby raising the costs of inputs to rivals of buyer by creating a price floor.

By contrast, the Commission is investigating MFN clauses that operate to the benefit of sellers, which individually lack market power. For this reason, the MFN clauses at issue here give the monopolistic pay-TV buyer an incentive to buy at the lowest possible costs to avoid the financial consequences of having to apply price increases across the entire range of its contracts. As such, these MFN clauses may in fact operate to lower entry barriers by keeping the costs of inputs down.

SIMPSON THACHER & BARTLETT LLP

425 LEXINGTON AVENUE
NEW YORK, NY 10017
TEL: +1 212 455 2000
FAX: +1 212 455 2502

CONTACT: KENNETH R LOGAN, PETER E KAZANOFF, AND JULISSA REYNOSO

WEBSITE: WWW.STBLAW.COM

Simpson Thacher & Bartlett LLP has a diverse and active antitrust practice both domestically and internationally. All aspects of antitrust work—civil and criminal litigation, representing parties before government enforcement agencies, advice in connection with mergers and acquisitions and day-to-day antitrust counselling on compliance, pricing, distribution issues and relationships with competitors—are handled through the firm's Litigation Department. There is a core group of eight partners based in New York and London, one counsel and approximately 35 associates who devote a substantial portion of their time to competition matters, although a far larger group of litigators has had experience on specific antitrust issues.

Simpson Thacher & Bartlett LLP has developed a reputation for bringing complex, multi-defendant antitrust litigations to trial, supported by the depth of a strong, broad-based litigation practice. The antitrust lawyers work comfortably with economists and other experts; they manage extensive data and document retrieval systems; and they lead efficient teams of lawyers on complex cases, frequently in multiple jurisdictions. Cases can be staffed, as needed, from New York, London, Palo Alto and Los Angeles.

Both the firm's antitrust practice as well as its litigation practice have been rated currently as the top practices in New York, and the firm's more senior antitrust lawyers are regularly recognised as leading antitrust lawyers in the US and internationally.

18 Media sjc 67-70 22/9/04 1:46 pm Page 70

Because MFN provisions are common in licensing arrangements throughout entertainment history, the EC's treatment of the competitive impact of such contract provisions bears close scrutiny.

Conclusion

Technology and piracy will continue to cause dislocation in the media and entertainment industries. The high-risk nature of the entertainment industry also causes companies to attempt to hedge that risk through arrangements with suppliers, customers and competitors. As industry participants develop new business tactics, distribution arrangements, and mergers, joint ventures, and alliances in the face of the changes in the marketplace, they will continue to draw the attention of both regulators and private plaintiffs. Horizontal agreements or mergers among direct competitors will continue to be closely scrutinised. Efficient distribution arrangements and vertical mergers, despite their impact on smaller competitors, are likely to be treated with greater tolerance.

Notes

1 See 'EMI and Time Warner withdraw current EC clearance application' (5 Oct 2000) available at http://www.emigroup.com/news/pr69.html.

2 See 'EMI and Bertelsmann End Merger Discussions' (1 May 2001) available at http://www.emigroup.com/news/pr106.html.

3 The FTC did announce on 28 July 2004 that it had closed its non-public investigation into whether the proposed joint venture violated Section 7 of the Clayton Act or Section 5 of the FTC Act. See FTC, 'FTC Closes Investigation of Joint Venture Between Bertelsmann AG and Sony Corporation of America' (28 July 2004), available at http://www.ftc.gov/opa/2004/07/sonybmg.htm.

4 See European Commission, 'Commission opens in-depth investigation into *Sony/Bertelsmann* recorded music venture' (12 Feb 2004), available at http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/04/200&format=HTML&aged=0&language=EN&guiLanguage=en.

5 See European Commission, 'Commission decides not to oppose recorded music JV between Sony and Bertelsmann' (20 July 2004), available at http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/04/959&format=HTML&aged=0&language=EN&guiLanguage=en.

6 Id.

7 Id.

8 Complaint, *United States v EchoStar Comm'n Corp, et al,* 1:02 CV2138, (DDC 2002), available at http://www.usdoj.gov/atr/cases/f200400/200409.htm.

9 In the Matter of Application of EchoStar Communications Corp, 17 FCCR 20559 (18 Oct 2002). The FCC concluded that the merger would eliminate a current viable competitor in every market in the country, such that each US household would effectively face either a monopoly or a duopoly. The denial marked the first instance since the 1970s that the FCC blocked a deal. The FCC reviews such transactions to determine whether they will serve the public interest; the DoJ's mandate is to decide whether a merger is likely to substantially lessen competition in violation of Section 7 of the Clayton Act.

10 In the Matter of General Motors Corporation and Hughes Electronics Corporation, Transferors And The News Corporation Limited, Transferee, For Authority to Transfer Control, Memorandum Opinion and Order, 19 FCC Rcd 473, at ¶ 180 (14 Jan 2004).

11 Indeed, the FCC found that in the absence of such a vertical relationship, the relative bargaining positions of broadcasters and MVPDs generally were in equipoise:
"Both programmer and MVPD benefit when carriage is arranged: the station benefits from carriage because its programming and advertising will likely reach more households when carried by MVPDs than otherwise, and the MVPDs benefit because the station's programming adds to the attraction of the MVPD subscription to consumers. Thus, the local television broadcaster and the MVPD negotiate in the context of a roughly even 'balance of terror' in which the failure to resolve local broadcast carriage disputes through the retransmission consent process potentially damages each side greatly in their core business endeavour."
News Corp/DIRECTV, at ¶ 180.

12 Importantly, the FCC has found that the 'good faith' requirement is presumptively satisfied when a broadcast network seeks carriage of affiliated cable programming in exchange for retransmission consent rights. In the Matter of Implementation of the Satellite Home Improvement Act of 1999; Retransmission Consent Issues: Good Faith Negotiation and Exclusivity, First Report and Order, 15 FCC Rcd 5445, at ¶ 56 (16 March 2000).

13 *EchoStar Satellite LLC v Viacom, Inc*, No. C 04-0049-CW (ND Cal Filed 7 Jan 2004).

14 *Verizon Communications Inc v Law Offices of Curtis V Trinko, LLP*, 124 S Ct 872 (2004).

15 Disney and Fox announced a rival joint venture called Movies.com in September 2001. The DoJ also investigated Movies.com until Disney and Fox abandoned the venture in 2002.

16 US Dep't of Justice, Antitrust Division, News Release: 'Justice Department Closes Antitrust Investigation Into the MovieLink Movies-On-Demand Joint Venture', 2004 WL 1234597, at *1 (DOJ 04-388 3 June 2004).

17 *Antidote Int'l Films, et al v MPAA*, 03 Civ 9373 (MBM) (SDNY filed 24 November 2003).

18 *See A&M Records, et al v Napster, et al*, 239 F.3d 1004 (9th Cir 2001) ('Napster I'); *A&M Records, et al v Napster, et al*, 284 F.3d 1091 (9th Cir 2002) ('Napster II').

19 *Metro-Goldwyn-Mayer Studios Inc, et al v Grokster Ltd, et al*, 259 F Supp 2d 1029 (C.D. Cal. 2003).

20 *Metro-Goldwyn-Mayer Studios Inc, et al v Grokster Ltd, et al*, Nos. 03-55894, 03-55901, 03-56236, 2004 WL 1853717, at *9 (9th Cir 19 Aug 2004).

21 *Metro-Goldwyn-Mayer Studios Inc, et al v Grokster Ltd, et al*, 269 F Supp 2d 1213 (CD Cal 2003).

22 See 'Studios Score a Success,' *Financial Times*, 10 May 2004.