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Antitrust Developments in the Media and Entertainment Industries

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Antitrust issues continue to play a central role in the media and entertainment industries, both in transactions and through litigation. The high-risk, capital-intensive nature of the media business, rapid changes in distribution technology that reward 'first-movers', and intense consumer interest in popular culture all combine to push antitrust issues to the forefront with both government enforcement agencies and private litigants.

This article highlights some of the more significant recent transactions and litigations involving the media and entertainment industries. First, in 2008, the Antitrust Division of the Department of Justice (DoJ) and the Federal Communication Commission (FCC) approved the merger between satellite radio operators Sirius and XM. The merger, announced 19 February 2007, took well over a year to receive regulatory approval from both agencies, and drew significant attention from a number of industry players – terrestrial radio broadcasters in particular – that actively campaigned against the merger. Second, in a recent putative class action antitrust lawsuit, the country's largest cable programmers and distributors were sued over claims that their alleged bundling of programming services forces consumers to pay for services they do not want. Third, Apple's ascension as a dominant firm in companion software (iTunes) and hardware (iPod) businesses and the steps it takes to maintain its market positions continue to attract antitrust scrutiny. A related issue is the degree to which Apple's suppliers and competitors, faced with such a dominant player, are permitted to cooperate with each other through joint ventures and other combinations in order to provide alternative distribution channels for their music. Fourth, private antitrust litigation has followed government approval of certain acquisitions when third parties have been unsuccessful in persuading merger authorities to block transactions or impose remedies to protect their asserted interests. The private litigation challenging the arrangements by which Comcast and Time Warner acquired assets of cable operator Adelphia in bankruptcy proceedings, swapped cable systems and dealt with programmers – after the litigants had unsuccessfully raised these concerns during the merger review process – exemplifies the risks of private litigation in the US even after merger approval has been obtained. Fifth, while copyright misuse defences grounded in antitrust and antitrust counterclaims mirroring misuse defences have continued to complicate copyright infringement actions, at least one federal judge flatly dismissed such counterclaims in a recent case.[2] Finally, all of this has been occurring against a broader backdrop of the US Supreme Court imposing more rigorous scrutiny upon private antitrust actions.[3]

Sirius/XM

On 24 March 2008, the DoJ granted unconditional antitrust clearance to the proposed merger of Sirius and XM, the only two satellite radio providers in the US.[4] A number of lawmakers, consumer groups and terrestrial radio broadcasters opposed the merger, arguing that it would create a satellite radio monopoly. The DoJ explicitly rejected claims that the merger would create an anti-competitive monopoly and instead concluded that the merger may benefit consumers through lower prices. The government based its conclusion on a number of findings: a lack of competition between the parties in important segments even without the merger, the competitive alternative services available to consumers, technological change that is expected to make those alternatives increasingly attractive over time, and efficiencies likely to flow from the transaction that could benefit consumers. The DoJ focused its analysis on the competitive effects in the two primary distribution channels for satellite radio service – car manufacturers that install satellite radio equipment directly into new cars (OEM) and retail sales. In each of these distribution channels, the DoJ found that customers rarely switch between Sirius and XM, consistent with the conclusion that competition between the two providers is limited.

While OEM distribution accounts for the predominant and growing share of new satellite radio subscriptions, the DoJ found that significant competition between Sirius and XM would not occur for many years since the competitive terms governing the arrangements with OEMs are subject to existing sole source contracts that would remain in effect through 2012 or beyond. In the mass market retail arena, while the parties might compete directly in the future, the DoJ concluded that the merger would not cause anti-competitive effects. Even absent the merger, the DoJ found that Sirius and XM do not compete with each other for large segments of retail customers because they offer different and exclusive programming options. For example, a potential customer considering subscribing to XM in order to listen to Major League Baseball or to Sirius in order to listen to Howard Stern would not consider the other radio service to be an attractive option. Moreover, the DoJ found that many retail customers buy additional receivers to add to an existing car subscription, and thus would not respond to a price increase by choosing the other satellite radio provider's services given their preference for alternative audio entertainment offerings. After excluding these segments of the actual and potential retail subscriber base, the DoJ found that 'the evidence did not demonstrate that the number of current or potential customers that view XM and Sirius as the closest alternatives is large enough to make a price increase profitable'. Additionally, the DoJ concluded that the parties could not identify and price discriminate against those actual or potential customers who might see the services as the two closest substitutes.

The DoJ also credited a number of other arguments proffered by the merging parties. First, it found that satellite radio competes with a number of audio alternatives, including traditional AM/FM radio, HD Radio, MP3 players, and audio offerings delivered through wireless technology. This suggests that the relevant product market for purposes of antitrust analysis is broader than satellite radio alone. Second, in the future, consumers would benefit from additional audio entertainment options since technological changes, including formats currently under development, are likely to make alternatives to satellite radio increasingly attractive over time. Finally, and perhaps most significantly, the DoJ concluded that the significant variable and fixed cost savings that the parties anticipate realising through the merger 'alone likely would be sufficient to undermine any inference of competitive harm'. The DoJ's explicit acknowledgement of merger-related efficiencies as a sufficient justification for approving the transaction is one of the most interesting developments in merger review in the US. Under the Horizontal Merger Guidelines, neither the DoJ nor the Federal Trade Commission will 'challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anti-competitive in any relevant market'. However, in practice, both agencies have been reluctant to grant regulatory approval on the basis of potential merger-related efficiencies alone, and few merging parties have satisfied the agencies' stringent standard. The DoJ's acknowledgment that it would have been willing to approve the transaction on the basis of such efficiencies underscores the significance of the specific and substantial synergies that the parties were able to present.

The merger also required regulatory clearance from the FCC – a significant hurdle because the companies were prohibited from combining under terms of their licences. Under the Satellite Licensing Order the FCC adopted in 1997 when it issued satellite licences for XM and Sirius, the FCC prohibited either entity from owning both satellite radio licences. According to the order, the 'prohibition on transfer of control will help assure sufficient continuing competition in the provision of satellite service'. Ultimately, the FCC approved the transaction, finding that the merger would be in the public interest. The FCC agreed that the market had changed since the two companies formed, with the growing popularity of internet radio, iPods and other advances in audio technology.[5] The companies voluntarily agreed to a set of conditions, including a three-year price cap, a limited 'à la carte' offering that would be available within three months of the close of the deal, and an 8 per cent set-aside of 'full-time audio channels' for public interest and minority programming.

Brantley v NBC Universal et al

On 20 September 2008, an antitrust suit was brought against the largest television programmers and distributors in the US. The main allegation was that the defendants restrained competition by offering only 'pre-packaged tiers' of programmes and by refusing to allow customers to order on an à la carte basis.

The federal district court in California refused to dismiss the complaint at the pleading stage.[6] The court found that the cable operators, direct-broadcast satellite companies and cable programming service providers had failed to demonstrate that there were insufficient allegations that the consumers who sued them were not injured by the defendants' business practices. Plaintiffs' allegations that programmers control key broadcasting and cable channels and can use them to exclude independent programmers were found to be sufficient to state an antitrust claim.

The court did not accept the defendants' argument that the plaintiffs failed to adequately allege that programmers have market power or that any cable channels have actually been excluded by the alleged bundling practices. The court noted that these arguments 'may eventually prove to be true, [but] they require a submission of evidence'. The court also rejected the defendants' arguments that the plaintiffs failed to properly allege a product market and a geographic market. The court did, however, leave open the possibility that the 'defendants' critique of the geographic market may eventually create problems for a nationwide class and a nationwide geographic market may be untenable as a factual matter'. Finally, the court decided that although the plaintiffs were indirect purchasers of video programming,[7] they had alleged 'enough of a conspiracy to qualify for the co-conspirator exception' in *Illinois Brick* 'by claiming that the programmers and distributors entered into a series of vertical agreements that enabled them to reap anti-competitive profits at the expense of consumers'.[8] The court arrived at this conclusion despite acknowledging that the 'plaintiffs have left out of the [complaint] many of the key allegations regarding the distributors' motive, intent and actions taken to join any conspiracy with the programmers'. The litigation is currently ongoing.

FCC chairman Kevin Martin has long been a proponent of à la carte video programming, arguing that consumers pay more under the current system of pre-packaged tiers because they are required to purchase more channels than they actually want. The cable industry has responded that rather than providing consumer benefits, à la carte pricing would result in higher average subscriber fees, less investment in programming content, fewer newly launched programming services, and less diversity in programming. By removing networks from a tier that is available to tens of millions of customers, a pay-per-channel system would significantly reduce the advertising base of most networks. As networks lose advertising revenues that make up the bulk of their programming and operating budgets, they will face higher marketing costs in order to continue to deliver high quality and diverse programming. These higher costs would be reflected in higher retail cable prices. To the extent that customers are unwilling to pay higher prices for certain networks, those networks would have no choice but to reduce the quality and attractiveness of their programming, or go out of business altogether.

The Apple iPod/iTunes antitrust litigation

Apple's iTunes store has now surpassed Wal-Mart to become the number one music retailer in the US, with over 50 million customers, over 4 billion songs sold, and the world's largest music catalogue of over 6 million songs.[9] At the same time, Apple's iPod sales represent approximately 90 per cent of the digital music player sales in the US. This parallel success in both the software and hardware segments is at least to some degree the result of the lack of interoperability between the iPod and other online music stores. The vast majority of songs available on iTunes are protected by Apple's copy protection software (limiting play to iPods), though some songs are now also available copy protection-free for a higher price. This lack of interoperability has been challenged by European antitrust and consumer protection agencies, primarily in France and Scandinavia, and is the subject of putative class action litigation in the US. At the pleading stage, two California courts denied Apple's motions to dismiss claims of an illegal tie between iTunes and iPods as well as a monopolisation claim.[10] Plaintiffs alleged that Apple possesses, through its iTunes/iPod franchise, monopoly power in the markets for the sale of digital music online and portable hard drive digital music players. Apple's primary factual defence is that music downloaded from iTunes can be played on numerous computers that are not manufactured by Apple, and that the iPod is capable of playing music from CDs as well as music downloaded from iTunes. Further, Apple argues that its proprietary digital rights management software is necessary, and appropriate, to protect copyrighted content.

A related issue is to what extent suppliers and distributors of music can take steps in response to Apple's market dominance. For example, in April 2008, MySpace, the world's largest and most popular online social network, together with Sony BMG Music Entertainment, Universal Music Group, and Warner Music Group announced the formation of a joint venture designed to combine the most popular music community in the world with the most comprehensive catalogue of music content available online, unveiling a host of new music services and monetisation models.[11] Moreover, Amazon.com, which has already overtaken competitors like Wal-Mart and RealNetworks' Rhapsody to become the second-biggest online store after iTunes, is reportedly in discussions to join this joint venture.[12]

US antitrust laws recognise that competitors may appropriately need to collaborate through joint ventures to achieve efficiencies that each could not attain on its own. The government commonly scrutinises joint ventures and trade association activities to ensure, among other things, that they do not facilitate 'spillover' effects that result in anti-competitive exchanges of information or concerted refusals to deal. Joint venture partners and trade associations commonly set appropriate guidelines and firewalls necessary to ensure that the joint venture and trade association efforts would withstand scrutiny in the event of government investigations or private actions.

The *Comcast/Adelphia* litigation

Following Comcast and Time Warner's bid to acquire Adelphia's cable assets in 2005, and after the FCC and the DoJ cleared the transaction, the America Channel commenced a private action in federal court in Minnesota to enjoin the transaction.[13] The America Channel alleged, inter alia, that Comcast and Time Warner engaged in a concerted refusal to deal with it, and that the partition and swap of the Aldephia assets was an illegal market partitioning agreement. The America Channel also alleged that only two of 114 independent networks (networks in which no merger cable operator had an equity interest) that sought carriage on Comcast's or Time Warner's cable systems network from 2003 through May 2005 had been granted carriage, and that Time Warner and Comcast had foreclosed competition by denying the other 112 requests. The court dismissed the complaint on the basis that it had failed adequately to allege a conspiracy, particularly in light of the pleading standards set forth in May 2007 by the Supreme Court in *Bell Atlantic Corp v Twombly*.[14] The court dismissed the alleged horizontal partitioning claims as not leading to antitrust injury because the America Channel had already been denied carriage by Comcast and Time Warner prior to the Adelphia acquisition and swaps. The court also dismissed the America Channel's monopolisation claims because the America Channel had not identified a relevant geographic market within the multichannel video programming distributor market in the US but instead identified inconsistent markets. The court also noted that the America Channel had failed to identify any causal connection between the attempted monopolisation and the alleged injury.

However, additional private actions filed against Comcast in Pennsylvania arising out of the Adelphia purchase led to a different outcome at the pleading stage.[15] These claims were filed on behalf of cable customers in Philadelphia, Chicago and Boston. The allegations are that Comcast has acquired monopoly power in these markets through asset swaps with actual or potential competitors and that cable companies have agreed not to overbuild in each other's excessive franchise areas. Comcast argued that the plaintiffs lacked standing because there was no cognisable harm to competition or the plaintiffs because the swaps of cable assets did not result in a change in the basic market structure in these three regions but only resulted in the substitution of one cable operator, with an exclusive cable franchise in a particular geographic region, for another competitor. The court rejected Comcast's argument and held that the parties to the swaps were actual or at least potential competitors in the relevant geographic regions. Importantly, the court noted that the fact that the horizontal allocation was pursuant to an asset swap did not shield the transaction from being categorised as per se unlawful for pleading purposes. Nor did the government's approval of the merger shield it from being challenged as a per se prohibition.

In contrast to the dismissal by the Minnesota court, the Pennsylvania court did not dismiss the claims relating to the acquisitions of cable systems that did not involve market allocation, claims that all parties agreed should be analysed under the 'rule of reason', even though the plaintiffs failed to define explicitly the relevant product markets. The court liberally construed the complaint in finding that the plaintiffs had sufficiently alleged the relevant geographic markets.

The Pennsylvania court initially denied Comcast's motion to dismiss prior to the Supreme Court's ruling in Twombly. Comcast then asked the court to reconsider its decision in light of that decision.[16] The court, however, reading Twombly narrowly, noted that it, 'by its own terms [...] did not impose a heightened pleading standard' and declined to alter its decision. On 2 May 2007, the court certified a class of Comcast subscribers in the 16-county Philadelphia metropolitan area, including six Pennsylvania counties, two Delaware counties and eight New Jersey counties. Litigation in the case is ongoing.

The antitrust 'defence' to copyright infringement

As the music industry continues to attempt to shut down illegal peer-to-peer networks, several high-profile lawsuits have been brought against networks such as Napster, Kazaa, Grokster, Baidu and, more recently, Lime Wire. In these cases, copyright owners, either individually or through trade associations such as the Recorded Industry Association of America or the International Federation of the Phonographic Industry, sue to enjoin copyright violations. In response, it has become routine for the alleged infringer to assert a copyright misuse affirmative defence based on antitrust theories and often an antitrust counterclaim mirroring the misuse allegations.

For example, when the RIAA sued Lime Wire LLC in 2006, Lime Wire countersued claiming that the music labels engaged in antitrust violations, including collusive price-fixing, and conspiring to hamper Lime Wire's technology by refusing access to its hash-based filtering without obtaining a licence. A federal court in New York dismissed all of Lime Wire's claims.[17] On the price fixing allegations, the court ruled that Lime Wire had failed to show that it specifically had suffered harm, and thus did not have antitrust standing as its allegations under the Sherman Act required. On the licensing issues, it found that Lime Wire had been specifically harmed, but that it had not 'identified any additional facts it would plead that would enable it, for example, to demonstrate the existence of a conspiracy'.

* * *

The high profile of the media industry and the high risks of the business itself assure that it will continue to be a target of antitrust scrutiny by suppliers, customers and competitors, as well as by the government.

Notes

1 Simpson Thacher & Bartlett LLP was counsel to Sirius in its merger with XM, and is counsel to one of the defendants in *Rob Brantley et al v NBC Universal Inc et al*, No. CV-07-06101 (CD Cal).

2 See *Arista Records et al v Lime Wire et al*, No. 06-CV-5936 (SDNY, 3 December 2007).

3 See *Bell Atlantic Corp v Twombly*, 127 S Ct 1955 (21 May 2007).

4 Statement of the Department of Justice Antitrust Division on its Decision

to Close its Investigation of XM Satellite Radio Holdings Inc's Merger with Sirius Satellite Radio Inc, 24 March 2008, available at www.usDoJ.gov/atr/public/press_releases/2008/231467.pdf.

5 Memorandum Opinion and Order and Report and Order, FCC MB Docket No. 07-57, 25 July 2008, available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-08-178A1.pdf.

6 *Brantley et al v NBC Universal Inc et al*, No. CV-07-06101, Order Denying Defendants' Motion to Dismiss Second Amended Complaint (CD Cal, 25 June 2008).

7 Indirect purchasers, ie, individuals purchasing a product at a point in the supply chain removed from the anitrust violation, generally have no entitlement to sue under section 4 of the Clayton Act. See *Illinois Brick v Illinois*, 431 US 720, 728-29 (1977).

8 See *State of Ariz v Shamrock Foods Co*, 729 F.2d 1208, 1211-13 (9th Cir. 1984) (conspiracy between wholesale dairy and retail grocery stores to fix retail price not barred by *Illinois Brick*).

9 Press Release, iTunes Store Top Music Retailer in the US, 3 April 2008, available at www.apple.com/pr/library/2008/04/03itunes.html.

10 See *Slattery v Apple Computer Inc*, WL 2204981 (ND Cal) and *Tucker v Apple Computer Inc*, 493 F Supp 2d 1090 (ND Cal). The cases were consolidated on 19 March 2007. A related class action complaint, *Somers v Apple Inc*, was filed on 31 December 2007 in the United States District Court for the Northern District of California, alleging various claims including alleged unlawful tying of music and videos purchased on the iTunes Store with the purchase of iPods and vice versa and unlawful acquisition or maintenance of monopoly market power.

11 MySpace, Sony BMG Music Entertainment, Universal Music Group and Warner Music Group Partner, Reuters, 3 April 2008, available at www.reuters.com/article/pressRelease/idUS167134+03-Apr-2008+BW20080403.

12 Amazon: The Avis of digital music, CNN Money, 31 July 2008, available at http://money.cnn.com/2008/07/30/technology/amazon.fortune.

13 See *America Channel, LLC v Time Warner Cable Inc*, No. 06-2175, 2007 WL 142173, 2007 WL 1892227 (D Minn).

14 127 S Ct 1955 (21 May 2007).

15 See *Glaberson v Comcast Corp*, No. 03-6604, 2006 WL 3762028 (ED Pa, 19 Dec 2006).

16 See *Behrend v Comcast Corp*, Nos. 03-6604, 07-218, 07-219, 2007 WL 2221415 (ED Pa, 31 July 2007).

17 *Arista Records et al v Lime Wire et al*, No. 06-CV-5936 (SDNY, 3 Dec 2007).

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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, Washington and London, two counsel and approximately 40 associates who devote a substantial portion of their time to competition matters, although a larger group of litigators also 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 and they lead efficient teams of lawyers on complex cases, frequently in multiple jurisdictions. Transactions and cases can be staffed, as needed, from New York, London, Washington, DC, Palo Alto, Los Angeles, and Beijing.

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.

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Kenneth R Logan has been a litigator and antitrust practitioner for more than 30 years at Simpson Thacher & Bartlett LLP and has handled a broad range of complex litigations and transactions. He is consistently ranked as one of the leading antitrust lawyers in the United States.

Mr Logan has developed a substantial background in issues affecting the health care, financial services, media and entertainment, telecommunications, pharmaceuticals and various manufacturing industries, regularly providing antitrust advice on both US and international matters. Mr Logan has conducted a range of complex commercial litigations and arbitrations involving Express Scripts Inc, ITT Industries, Kohlberg Kravis & Roberts, Princeton University, Seagram, NBC Universal, Viacom, Warner Music Group, Wyeth and others. He has also provided advice in connection with obtaining approval of a large number of acquisitions and joint ventures in the US, Europe and elsewhere.

Mr Logan graduated from Princeton University in 1967 and from the University of Pennsylvania Law School in 1972. He frequently writes and speaks on US and international antitrust issues. ■

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Joseph Tringali is a partner at Simpson Thacher & Bartlett LLP in the litigation department, where he has represented clients on general commercial litigation with an emphasis on antitrust matters. He has represented plaintiffs and defendants in jury and bench trials and argued appeals in federal and state appellate courts in diverse areas including antitrust, breach of contract, copyright infringement, false advertising, employment discrimination and civil rights. Primarily, he has litigated antitrust actions on behalf of both plaintiffs and defendants and counsels clients under the Sherman, Clayton, Robinson-Patman and Hart-Scott-Rodino Acts including cases alleging monopolisation, price fixing and other restraints of trade, and price discrimination. He has also handled numerous merger transactions before the Department of Justice, the Federal Trade Commission, various state antitrust enforcement agencies, and the European Commission including representing Blackstone in its proposed acquisition of Hilton Hotels, Gerdau Ameristeel in its proposed acquisition of Chaparral, KeySpan in its acquisition by National Grid, and Kmart in its acquisition of Sears. In addition, he has represented Kohlberg Kravis Roberts in a civil antitrust action alleging collusion among private equity firms, MasterCard in antitrust actions brought against it by rivals American Express and Discover, Weyerhaeuser in several monopolisation cases regarding alder lumber, and Lehman Brothers and JP Morgan Chase in a lawsuit alleging price fixing regarding the fee charged in certain IPOs. He has been recognised in the antitrust field by the following publications: *Chambers USA 2007*, *The Legal 500*, *The International Who's Who of Competition Lawyers*, and the *Guide to the World's Leading Competition and Antitrust Lawyers*.

Mr Tringali joined the firm in 1983 and became a partner in 1989. He received his BA from Wesleyan University in 1977 and his JD from the New York University School of Law in 1980, where he was an editor of the Law Review. ■

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