line."[104] In the past, there have been limited and generally disappointing attempts to do primitive versions of Interactive Television, such as the Qube experiment in the early 1980s and the full service network of the early 1990s. Now, however, the technologies are in place to create a market estimated to generate revenues of approximately $25 billion by 2005.[105] As *Broadcasting & Cable* put it in an editorial accompanying its recent 35 page cover story on Interactive Television: "This time it's different."[106]

The term "Interactive Television" is used by different speakers to describe a wide variety of services. Some of the services, can be offered with technologies that already are available in the market. Others, including the core Interactive Television experience, will only be available as a new generation of high-powered set-top boxes is rolled out.

The following are all products that will be offered under the name Interactive Television:

(a) electronic program guides;

(b) video on demand;

(c) personal video recorders;

(d) Internet content, including instant messaging, chat rooms and e-mail; and

(e) the ability to interact with broadcast programming and advertising in a host of ways.

While each of the products and services listed in (a) through (d) has a large commercial potential and may substantially change viewing habits, it is the possibilities of (e), that promise

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104 *See* Ken Kerschbaumer, *AOL TV Launches, With Much Bravado; Schuler Says Set-Top Offers Chance For New Revenue* Streams, BROADCASTING & CABLE, June 19, 2000, at 6.

105 *See* Ken Kerschbaumer, *Fullfilling the Promise: The Cable Industry Is Poised To Capitalize on the Concept's Long-Awaited Potential*, BROADCASTING & CABLE, July 10, 2000, at 22 (reporting Meyers Group estimate). Another example is $20 billion by 2004. *See* FORRESTER RESEARCH, INTERACTIVE TV CASH FLOWS 13 (1999).

106 *Hold the Anchovies*, BROADCASTING & CABLE, July 10, 2000, at 90.

to make Interactive Television a truly revolutionary product, one that fundamentally changes viewing habits and the television industry, particularly when combined with the Internet capabilities of the type listed under (d). As Cisco Systems puts it, cable has the ability to "combine on-demand, interactive, and broadcast services into a unique service offering . . . The real value of broadband cable will be derived from a combination of broadcast video, on-demand video content, personalized content, and Internet content."[107]

When broadcast programming becomes truly interactive, it will allow consumers to:

(i) Select television and Internet content by genre (*example*: "click here for news")

(ii) obtain more details about a particular news story by "drilling down" (*example*: "click here to get more information about the shooting at the National Zoo")

(iii) Interact with advertising messages (*example*: "click here if you would like to test drive this new Jeep")

(iv) call up and view simultaneously Internet content related to a television program (*examples*: "click here for real time statistics on this football game" or "click here to get the recipe being demonstrated on this cooking show")

(v) purchase goods and services featured in a television show (*example*: "click here to buy Ally McBeal's sweater")

(vi) select different camera angles and different perspectives on instant replay at a sporting event, and

(vii) simultaneously engage in e-mail, Instant Messaging or chat rooms while watching television on the same screen (*example:* "click here to participate in a chat room or line poll regarding this political debate").

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[107] CISCO SYSTEMS, INC., NEW REVENUE OPPORTUNITIES FOR CABLE OPERATORS FROM STREAMING-MEDIA TECHNOLOGY 1-2 (1999).

VI. THERE WILL BE NO CLOSE SUBSTITUTES FOR CABLE IN THE PROVISION OF INTERACTIVE TELEVISION FOR THE FORESEEABLE FUTURE

Cable, also known as hybrid fiber coax ("HFC"),[108] networks are the only distribution platforms capable of delivering the full Interactive Television experience, and this is not likely to change for the foreseeable future. Broadband industry analysts uniformly agree that, "[o]f all of today's alternatives, the HFC [cable] plant provides the best platform for the development of . . . consumer based multimedia."[109]

Other technologies such as DSL, DBS, MMDS, and fixed wireless may be suited to transmit certain broadband services, but, for the foreseeable future, none is capable of offering full-fledged, two-way interactive video on a commercially viable basis:

- ***DSL.*** Digital subscriber line ("DSL) was intended primarily to transmit data. With the exception of a very limited trial, there is little indication in the marketplace that DSL will be a distribution mechanism for full motion video, much less Interactive Television service, for the foreseeable future.

  DSL's substantial technical limitations certainly were not lost on AOL two years ago, when, in the context of opposing AT&T's acquisition of TCI, it argued that DSL is "functionally distinct from broadband cable in terms of speed and expense. Moreover, almost one-half of all homes served by ADSL-equipped central offices may still not be able to make use of [DSL] because of technological limitations."[110]

- ***DBS.*** Digital broadcast satellite ("DBS") networks are now only suited to provide one-way service. Upstream communications through a telephone line makes DBS inadequate for fully Interactive Television. Future technological solutions to make DBS a feasible delivery system for Interactive Television

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108 As their name indicates, hybrid fiber coax networks use a combination of modern fiber optics and traditional coaxial cables. *See* SANFORD C. BERNSTEIN & CO., INC. & MCKINSEY & CO., INC., BROADBAND! 38 (2000) ("Bernstein & McKinsey Report").

109 *See* BEAR, STEARNS & CO., CABLE TV & BROADBAND 126 (2000) ("Bear Stearns Report").

110 Comments of America Online, Inc., *In re* Transfer of Control of Licenses from Tele-Communications, Inc., to AT&T, CS Docket 98-178, at 53 (filed Oct. 29, 1998) ("*AOL Comments in AT&T/TCI*").

services are uncertain at this time, and the likely costs to consumers would be extremely high. Moreover, the time to launch significant upgrades is likely to be such that AOL/Time Warner would have an almost insurmountable lead in the market.

- ***MMDS.*** Multichannel Multipoint Distribution System ("MMDS") started as a video platform years ago, but failed to compete with cable because of limited channel capacity and line-of-sight issues. Sprint and MCI WorldCom have recently bought up most of the MMDS spectrum in hopes of repositioning the technology as a high-speed data and voice platform, a strong indication that the technology is finished as a video platform.

- ***Fixed Wireless.*** Fixed-wireless networks are an adequate telephony solution, and may be suitable for data transmission as well, but are simply not a threat to cable in the Interactive Television arena because they lack sufficient bandwidth to carry video content.[111]

Cable has several other advantages that seal its triumph for the delivery of Interactive Television. *First*, cable has been the dominant distribution vehicle for one-way television for the past two decades, giving it a natural head start toward providing two-way Interactive Television.[112] *Second*, cable networks offer unparalleled upstream and downstream bandwidth, which is critical to meeting increased demand for two-way Interactive Television as opposed to today's one-way television format.[113] *Third*, cable providers, particularly Time Warner, already have a significant head start in the provision of Interactive Television because the most lucrative portions of the HFC plant (*i.e.*, serving affluent areas that most likely to adopt Interactive

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111 *See* Bernstein & McKinsey Report, at 54.

112 Cable networks claim 67 percent of the 99.4 million U.S. homes with at least one television, 70 percent of all U.S. homes actually passed by cable wires, and, most importantly, 82 percent of all multichannel video programming distribution subscribers. *See Sixth Annual Video Competition Report*, at ¶¶ 4-5, 19-22.

113 A recent Bear, Stearns study concluded that, "of all the platforms, . . . the HFC plant probably has the greatest flexibility to meet what we believe will be an increasing demand for upstream bandwidth [to carry multimedia applications]." *See* Bear, Stearns Report, at 124.

Television) have already been upgraded to support two-way Internet access.[114] *Fourth*, and finally, cable has the endorsement of strategic investors of the likes of AOL, AT&T, Microsoft, and Microsoft co-founder Paul Allen, all of which have voted with their pocketbooks in anointing cable the dominant distribution platform for Interactive Television.[115] AOL's probable acquisition and folding of RoadRunner into AOL Plus is yet further endorsement of cable as the preferred distribution platform for Interactive Television.

Indeed, the only possible competitive threat to cable in the distribution of Interactive Television services comes from cable itself, in the form of cable overbuilders. While overbuilders often have been unsuccessful in the past, the model has now changed because the overbuilder can now offer high speed Internet as well as cable television and potentially local telephone service. Thus, overbuilds are beginning to receive financing, but they are many years away from having any widespread significant competitive impact. By the time such systems are completed, any disciplining effect they might have on AOL/Time Warner's market power will be eliminated because they will be denied access to AOL/Time Warner's by-then-dominant Interactive Television content.

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[114] According to one study, by the end of 1999, over half of all U.S. homes were passed by cable that had already been upgraded to data-ready, two-way HFC, *see* Bernstein & McKinsey Report, at 1, and well over 60 percent of all high-income U.S. households were passed by upgraded HFC wires. *See id.*, at 26. As for Time Warner, which has been "the most advanced in upgrades of all cable companies and has pioneered interactivity and return path technology," *id.* at 35, roughly 85 percent of the company's 20 million cable households have been upgraded for two-way service. *See id.* at 19. In contrast, by the end of 1999, only 25 percent of current telephone lines had been upgraded for two-way DSL to the point of being able to serve residential subscribers and that, of course, is for data, not video, services. *See id.* at 28.

[115] *See* MERRILL LYNCH & CO., AOL TIME WARNER: YOU'VE GOT UPSIDE! 34 (2000) ("Merrill Lynch Report").

VII. PAST IS PROLOGUE: AOL/TIME WARNER WILL HAVE THE ABILITY AND INCENTIVE TO USE EXCLUSIONARY POWER IN THE INTERACTIVE TELEVISION MARKET

A. MEDIA INCUMBENTS HAVE LONG USED THEIR POWER TO EXCLUDE RIVALS IN EMERGING MARKETS

There is a long history in the media industry of incumbents exercising their power to dominate new markets and exclude emerging rivals. In the 1920s, newspaper members of the Associated Press tried to prevent radio stations from buying news from the AP news service.[116] In the 1950s, movie theater trade associations organized boycotts against studios that sold movies to television stations.[117] In the 1960s and 1970s, television stations and movie theaters tried to prevent studios from supplying movies to cable systems.[118]

Once the cable industry developed market power, it conformed to the pattern. In a 1988 report, the National Telecommunications and Information Administration found that only seven of seventeen vertically integrated networks offered programming to potential competitors, such as SMATV and MMDS.[119] The Commission's 1990 Cable Report also found that several vertically integrated firms had denied access to potential competitors.[120]

These problems continued even after the Commission began enforcing the program

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116 V. ROSEWATER, HISTORY OF COOPERATIVE NEWS-GATHERING IN THE UNITED STATES 292-94 (1970).

117 W. LAFFERTY. FEATURE FILMS ON PRIME-TIME TELEVISION, HOLLYWOOD IN THE AGE OF TELEVISION 235, 236-39 (1990).

118 Subscription Television: Hearings on H.R. 12435 Before the Subcomm. on Communications and Power of the House Comm. on Interstate Commerce, 90th Cong., 1st Sess. (1967); R. Gershon, *Pay Cable Television: A Regulatory History*, COMM. & L., June 1990, at 3, 7-12.

119 NTIA, VIDEO PROGRAMMING DISTRIBUTION AND CABLE TELEVISION: CURRENT POLICY ISSUES AND RECOMMENDATIONS 103 (1988).

120 *In re* Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable TV Services, Report 5 FCC Rcd. 4962, ¶ 114.

access rules. In one matter, the Commission effectively ordered Time Warner to provide access to its vertically affiliated network, Court TV, to Liberty Cable Co., a wireless operator competing with Time Warner's cable system in Manhattan.[121]

Time Warner and other cable MSOs also have created procedural entry barriers to companies seeking to enter into the cable business. For example, from 1992 through 1995, Time Warner filed opposition petitions and multiple comments in an attempt to prevent the FCC from allowing NYNEX to provide video dialtone service in parts of Manhattan.[122] In 1994 and 1995, TCI filed petitions and comments with the Commission urging it to deny Bell Atlantic and Southern New England Telephone's applications to provide video dialtone service.[123] And, of course, Time Warner is currently opposing the efforts of Memphis Networx to build a competitive broadband system, as discussed above.

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121 Time Warner Cable Petition for Public Interest Determination under 47 C.F.R. § 76.10002(c)(4) Relating to Exclusive Distribution of Courtroom TV, Memorandum Opinion and Order, 9 FCC Rcd. 3221 2 (1994).

122 *See In re* New York Telephone Company, Application for Authority under Section 214 of the Communications Act of 1934 to Construct, Operate, Own, and Maintain Facilities and Equipment to Test Video Dialtone Service in Portions of New York City, No. W-P-C-6836, Petition to Deny Section 214 Application (Dec. 14, 1992); Reply to Opposition to Petitions to Deny (Jan. 7, 1993); Comments on New York Telephone Company Answers (May 4, 1993); Response to Opposition to Petition for Reconsideration (Aug. 23, 1993); Comments on Motion for Extension (Feb. 7, 1995).

123 *See* The Bell Atlantic Telephone Companies, For Authority Pursuant to Section 214 of the Communications Act of 1934, as Amended to Construct, Operate, Own, and Maintain Facilities and Equipment to Provide Video Dialtone Service within Geographically Defined Portions of Their Telephone Service Areas, Petition to Deny of Tele-Communications, Inc., W-P-C-6966 (July 29, 1994). *In re* The Southern New England Telephone Company, Tariff F.C.C. No. 40, West Hartford Video Dialtone Tariff, Petition to Reject Southern New England Telephone Company's Video Dialtone Tariff for the West Hartford System, Transmittal No. 641 (Mar. 29, 1995); *In re* The Southern New England Telephone Company, For Authority Pursuant to Section 214 of the Communications Act of 1934, as Amended, to Construct, Operate, Own and Maintain Facilities to Test a New Technology for Use in Providing Video Dialtone Service in Specific Areas in Connecticut, Comments of Tele-Communications, Inc. on Motion to Revoke Market Trial Authorization, W-P-C-6858 (April 10, 1995; *In re* The Southern New England Telephone Company, For Authority Pursuant to Section 214 of the Communications Act of 1934, as Amended to, Construct, Operate, Own and Maintain a Commercial Video Dailtone System within Connecticut, Petition to Deny, W-P-C-7074 (June 9, 1995).

In the absence of Commission action in this proceeding, this long history of media industry exclusionary conduct surely will repeat itself in the world of Interactive Television. All of the same tools that dominant media companies used to monopolize in the past are available to AOL/Time Warner to monopolize Interactive Television in the future. Indeed, the present day tools to exclude, as shown by the videotape attached as Exhibit A, are superior to the tools available to earlier generations of would-be monopolists.

A cable operator now has "absolute control, down to the packet" of how content is distributed through its system.[124] Essentially, the cable operator can choose how every bit entering its system is treated. An MSO using this technology can:

1. Isolate network traffic by the type of application, even down to specific brands;
2. Create traffic policies to provide for admission control;
3. Prioritize packet types through preferential queuing; and
4. Specify, for instance, that video coming from internal servers receives precedence and broader bandwidth over video sourced from external servers.

The developer of the technology, Cisco Systems, in a paper entitled "Controlling Your Network – A Must For Cable Operators," stated in the Executive Overview that it "discusses how to prevent outside content providers from disrupting the cable network by delivering broadband content without authorization granted by the MSO."[125]

Thus, Time Warner already has the ability to discriminate against competitive content in a myriad of ways due to its local cable monopolies in twenty percent of the United States. What this merger does is marry that monopoly power to AOL's monopoly power in the OSP and instant messaging markets. It is the combination of these two types of monopoly power with the

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[124] CISCO SYSTEMS, INC., CONTROLLING YOUR NETWORK – A MUST FOR CABLE OPERATORS 1 (1999).

[125] *Id.*

technologies that allow perfect discrimination that will give AOL/Time Warner the ability to dominate the new Interactive Television market.

B. PRE-MERGER INCENTIVES FOR AN OPEN INTERACTIVE TELEVISION SYSTEM OUTWEIGH THE INCENTIVES FOR A CLOSED SYSTEM

To understand why this merger will so adversely affect interactive content competition, we must first address AOL's and Time Warner's pre-merger incentives. Pre-merger, AOL had substantial incentive to develop an open system set top box for Interactive Television. Indeed, AOL lobbied for regulations that would assure such open systems in the related Internet context. As AOL stated:

> Openness and competition have fueled the Internet's dynamic growth in the narrowband environment, which has led to a wealth of benefits to consumers and the U.S. economy. High-speed Internet access services can add to those benefits if deployed in a manner that fosters the consumer choice to which Internet users have become accustomed. But these benefits will not be fully or quickly realized if the providers of the underlying last mile broadband transport services confine their availability to one—their own Internet service provider.[126]

AOL's concern about openness extended to the interactive context, as AOL warned that the AT&T/MediaOne merger could threaten consumer choice:

> With this merger, AT&T would take an enormous next step toward its ability to deny consumers a choice among competing providers of integrated voice/video offerings—a communications marketplace that integrates, and transcends, an array of communications services and markets previously viewed as distinct.[127]

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[126] *See AOL Comments in AT&T/TCI*, at iv.

[127] Comments of America Online, Inc., *In re* Transfer of Control of FCC Licenses of MediaOne Group, Inc. to AT&T, CS Docket No. 99-351, at 9-10 (August 23, 1999) ("*AOL Comments in AT&T/MediaOne*").

AOL would benefit from an open system because it would encourage content providers to develop interactive content that is compatible with the AOL set top box. Such content will be very expensive and programmers are less likely to undertake such efforts unless AOL assures them the opportunity for an adequate return for a risky proposition. This return would come in the form of content provider control over their content, including control over the return path, navigation links, and advertising.

To be sure, AOL would want to build an exclusionary wall around the Interactive Television system as it has built one around its sister OSP. In addition, the cable operators would prefer a system that they controlled, and AOL would have some incentive to satisfy the desires of cable operators. However, Disney believes that the pre-merger environment would favor an open system in the end because Interactive Television is not compelling without true interactive content, which content providers, such as Disney, must produce. After all, would AOL want interactive instant replay on the Super Bowl to appear only on Microsoft's Interactive Television? Thus, interactive content providers would probably be able to develop long-term contracts that assure them control over their content.

Absent the merger, Time Warner also has mixed incentives. Time Warner has the same incentive as AOL to encourage the development of interactive content from multiple sources. They would fear being left out of the development of interactive content because programmers would prefer to put their efforts into developing for an open system rather than a closed system. Developers of Interactive Television operating systems, such as AOL and Microsoft, would also pressure Time Warner to agree to an open system.

Time Warner's incentives to close the system, however, are substantial. First, as set out above, Time Warner has substantial content of its own and could develop that content for

Interactive Television. To the extent that Time Warner can completely control the content, it can monopolize valuable new services that Interactive Television offers customers. For instance, it could assure that the navigation links are only to Time Warner Internet sites, *e.g.*, CNN rather than ABC. It could monopolize interactive advertising, merchant lists and concomitant interactive purchasing.

Second, Time Warner would want a closed system to build barriers that prevent rivals from entering and competing with Time Warner's cable systems. Cable overbuilders are the most likely to challenge Time Warner. As described above, the environment for overbuilds is more favorable than in the past because of the additional revenue streams that are now available, *e.g.*, high speed Internet access. Such entry would challenge Time Warner's cable monopoly and Time Warner has always acted to prevent such entry. One way to do so is to deny overbuilders Time Warner's vertically integrated interactive content, thereby eliminating the value proposition that might otherwise spur entry. An outright denial is not necessary. In the absence of rate of return regulation of content, Time Warner could simply overcharge overbuilders to deter them from entering Time Warner markets.

In a related context, AOL warned of the dangers to consumers if cable operators could build barriers to entry:

> We submit that ... the FCC should consider how [the AT&T/MediaOne] merger's video and Internet access components would ... shield cable from competition in the video marketplace.[128]

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[128] *AOL Comments in AT&T/MediaOne*, at 8.

Third, if Time Warner has any concern about rate of return regulation on its cable operation, it could evade such regulation by vertically integrating into interactive content. For accounting and regulatory purposes, it could then, shift its monopoly cable profits to its unregulated content subsidiary.

Despite these anticompetitive incentives, Disney believes that in the absence of the merger, unaffiliated content providers would possess enough countervailing power to assure an open system. The need for rapid development of interactive content would outweigh the anticompetitive incentives for a closed system. Neither AOL nor Time Warner would want to be left at the starting gate while set top box and cable competitors encouraged programmers to develop content for an open system.

C. POST-MERGER AOL/TIME WARNER WOULD HAVE THE INCENTIVE AND THE ABILITY TO CLOSE THE INTERACTIVE TELEVISION SYSTEM

Post-merger, the incentives would flip and AOL/Time Warner would design and maintain a closed system. First, post-merger AOL would acquire all of the incentives that Time Warner had to close the system. AOL would be vertically integrated into Time Warner's content. AOL also would want to protect the Time Warner cable monopoly. AOL further would want to deter overbuilders that might undermine its cable monopoly. Hence, AOL would no longer be a countervailing force for an open system.

Second, by marshalling the assets of AOL and Time Warner, AOL/Time Warner is much less likely to be left at the starting gate. As Merrill Lynch put it in an enthusiastic report on the acquisition, the AOL/Time Warner Interactive Television system will be: "the operating system

for consumer interactivity,"[129] indeed, "the operating system for everyday life."[130] With AOL's large subscriber base, consisting of more than one-half of ISP customers, and "sticky" applications, such as instant messaging and chat rooms, which will work well in the Interactive Television context, the combined entity would have a package that could not be duplicated by any rival. For example, AOL brings to the table over 150 million instant messaging "buddies" that could discuss the Super Bowl on a side bar of the television in real time. The same could be said about 1400 interactive chat rooms and a host of other AOL features.

Under the circumstances, content providers would have little choice but to develop for AOL/Time Warner Interactive Television, despite their loss of control. It would be the programmers who would fear being left at the starting gate, and they would just have to tolerate a variety of exclusionary tactics designed to maximize AOL/Time Warner revenue and minimize programmer control. These tactics include:

1. excluding competing interactive content and services (*e.g.*, dropping an interactive ABC);
2. force-feeding AOL/Time Warner/EMI content (*e.g.*, send the customer to CNN when he or she clicks on a "news" icon, instead of offering a selection of competitive news choices);
3. transmitting its own content "downstream" to consumers at preferential (*i.e.*, faster) data rates;
4. blocking critical, interactive "return path" communications between customers and competing content providers and services;
5. limiting customers' ability to access locally "cached" data to their own content;
6. favoring its own content in navigation systems and links;
7. favoring its own content with more simple and convenient consumer interfaces;
8. building its own merchant lists to the exclusion of the content provider's list; and

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[129] Merrill Lynch Report, at 9.

[130] *See id.*, at 7.

9. developing AOL/TW controlled interactive advertising, even if it undermines the content providers advertising message (*e.g.*, supplying a navigation link to Ford, when the content provider is advertising GM).

All of these tactics will, of course, discourage the development of unaffiliated interactive content but that is to the advantage of AOL/Time Warner because it leaves a vacuum for more Time Warner interactive content and because it erects entry barriers to overbuilders that need compelling interactive content to challenge AOL/Time Warner cable monopolies.

D. THE AOL-TIME WARNER CLOSED SYSTEM WILL SPREAD BEYOND TIME WARNER'S CABLE SYSTEMS

For the same reason that Time Warner has mixed incentives pre-merger, other MSOs have mixed incentives before and after the merger. To summarize, the other MSOs would favor an open system to generate compelling interactive content. They would favor a closed system to protect their cable monopolies and to extract the maximum revenue from interactive content. The network effects of the AOL/Time Warner system—over 150 million "buddies" for instant messaging, over 23 million subscribers to its OSP, chat rooms, proprietary content—would be a substantial selling card for the AOL/Time Warner interactive system, whether it is open or closed. To clinch the deal, AOL/Time Warner will offer incumbent cable operators a share of the revenue that would go to content providers in open systems. That is, AOL/Time Warner would offer the MSO some control of the return path, interactive merchant lists and interactive advertising. Finally, if the carrot is not enough, there is always the stick. As the American Cable Association Comments in this proceeding warned, AOL/Time Warner would threaten to withhold from or raise the price of its traditional marquee content to cable operators that do not accept the AOL/Time Warner closed system.

AOL/Time Warner has one additional tool to quickly proliferate its closed system. It can offer AT&T telephony on Time Warner systems in exchange for AT&T's deployment of the

AOL/Time Warner Interactive Television product. There is already a tentative agreement on the telephone portion of such an arrangement.

E. CONSUMERS WOULD BE HARMED BY THE CLOSED INTERACTIVE TELEVISION SYSTEM

The closed system would have several adverse effects. First, it would slow the development of Interactive Television, as content providers would be discouraged from creating content that mostly lines the pockets of AOL/Time Warner. Second, it would muffle the diversity of voices and consumer choice. Imagine the interactive system where the only navigation bar from ABC News is to CNN. Third, it will create three level barriers to entry. Anyone wishing to challenge AOL/Time Warner's hegemony would have to enter the market at three levels: set top operating system, cable, and interactive content. By raising entry barriers, AOL/Time Warner as well as its MSO partners could raise the price of carriage to both programmers and viewers.

Thus, the closed Interactive Television system would have many of the exclusionary features of AOL's walled garden and Time Warner's monopoly cable system. AOL/Time Warner will prevent interoperability, as AOL does with instant messenger; it will prohibit navigation links to nonaffiliated content as AOL does with its walled garden OSP; it will block certain competitive interactive content as Time Warner did with the Gemstar channel guide; and if any programmer has the temerity to compete, it will simply pull the plug, as Time Warner did when Disney tried to compete.

The very real possibility of this result is supported by the recent exchange of correspondence between Robert Iger, Disney's President, and Richard Parsons, Time Warner's President. Iger wrote Parsons on May 31, asking to discuss issues relating to equal treatment of content created by third parties as Time Warner implements Interactive Television. Parsons'

June 15 response was a string of platitudes, leavened by a refusal to negotiate directly with Disney and a suggestion that Disney agree to a joint statement warning of the dangers of government action. This exchange represents no change in Time Warner's position from the response Joe Collins, President of Time Warner Cable made in February to a similar letter from Anne Sweeney, President of the Disney Channel.

AOL/Time Warner can prove that Disney is wrong. All it has to do is come to the negotiating table and agree to arrangements with Disney and other content providers that assure nondiscriminatory access to the bottleneck pipe into the home and to the Interactive Television future. But AOL/Time Warner does not want this. It apparently agrees with Professor Lessig, who has pointed out, there will be rules made regarding the governance of the Internet; the only question is whether they will be written by corporations for their own benefit or by a government that wishes to ensure the lowest prices, the highest quality of products and services, a diversity of voices and consumer choice. AOL/Time Warner wants the former; the Commission should insist upon the latter.

If the Commission fails to act now, it almost certainly will have to take more drastic action in the future to protect openness and consumer choice. As AOL argued:

> The history of cable regulation demonstrates ... that failure to act now will likely require policymakers to pursue broader, more detailed intervention in the future in an effort to undo the more entrenched interests that will develop in the coming years.... [I]t should be clear that the question for policymakers is not *whether*, but *when* they will find themselves compelled to address the cable gatekeeper role in order to promote high-speed data transport services for Internet connections. Action now to lay out the pro-competitive foundation for video-enabled Internet services should ultimately require far less government intervention or oversight in the future.[131]

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[131] *AOL Comments in AT&T/TCI*, at v.

F. AOL-TV: The Shape of Anticompetitive and Anti-Consumer Behavior from AOL/Time Warner To Come.

AOL/Time Warner has started to implement its game plan for dominating the emerging market of Interactive Television services with the recent launch of AOL-TV. This summer, AOL-TV is being rolled out in selected markets, including Phoenix, Sacramento and Baltimore, to become the first Interactive Television service for mass-market consumers. The first version of AOL-TV will be delivered through a narrowband, telephone wire hook-up to an AOL-TV set-top box, keyboard and remote control. However, a more advanced version of AOL-TV delivered via broadband cable is expected this fall.

Broadband AOL-TV services promise to greatly enhance today's television viewing experience with the addition of AOL's Internet services such as e-mail, instant messaging, chat rooms, and interactive services, programming, and electronic program guides. In addition, AOL-TV promises to facilitate more consumer activity via television ("t-commerce"). For example, AOL and Citigroup announced a deal recently to offer financial products and online payment abilities to AOL customers across several AOL services including AOL-TV. This enhancement will enable AOL customers to obtain a full range of financial services through their television sets, including the ability to obtain mortgages, loans and credit cards, and to securely purchase goods and services, send money to friends and family, complete auction transactions and eventually transfer money between accounts.

With its vast Internet content holdings, and its ownership of content produced by Warner Bros., Warner Music, HBO, the Cartoon Network, TNT, and TBS, and its ownership and control of the broadband cable pipeline, AOL/Time Warner will have an unmatched capability to leverage its current power into an immediate dominant position in the Interactive Television services market. This spells trouble for consumer choice and the ability of unaffiliated content

and Interactive Television services providers to compete in this new market. Indeed, AOL/Time Warner has already established parameters for dealing with unaffiliated companies in the Interactive Television services market that signal an enormous potential for discriminatory behavior in the future. In its response to the Commission's question about any limitations that AOL-TV's content or advertising agreements might have, AOL/Time Warner said:

> Agreements with video programmers do not, however, place limitations on the right of a video programmer to obtain carriage of a particular interactive service, particular content, or advertising, except as to provisions by which partners agree: (1) to comply with AOL's design guideline templates and co-branding requirements; (2) to not provide advertisements, promotions, or links from competitors to AOL on AOL-TV itself; and (3) to not carry interactive content as to which AOL is bound by pre-existing exclusive rights of a third party.[132]

AOL/Time Warner's response leaves the door wide open for a host of anticompetitive conduct against unaffiliated content and Interactive Television services providers, including unreasonable refusals to deal, exclusive arrangements with third parties to freeze out competition and consumer choice, and discriminatory advertising practices. Furthermore, this smokescreen does nothing to keep AOL/Time Warner from using its market power to extract unfair arrangements and commitments from its "partners." Absent the imposition of structural and/or behavioral safeguards by the Commission, AOL/Time Warner will be free to make discriminatory business offers that unaffiliated content and Interactive Television service providers cannot refuse, destroying any hope for a robustly competitive market that would provide real choices for consumers.

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[132] *See* Response of AOL and Time Warner to Cable Services Bureau Document and Information Request of June 23, 2000, at 2 (filed July 17, 2000).

VIII. THE COMMISSION CANNOT APPROVE THE AOL/TIME WARNER ACQUISITION UNLESS IT DETERMINES THAT IT IS IN THE PUBLIC INTEREST AND PROCOMPETITIVE.

In accordance with Section 214(a) and Section 310 (d) of the Communications Act, as amended, the Commission must determine whether the proposed merger between AOL and Time Warner is in the public interest, convenience and necessity.[133] The Commission's responsibilities under the public interest standard go beyond the duty imposed on either the Federal Trade Commission or the Justice Department to determine whether or not a proposed merger will harm competition.[134] Rather, the public interest test requires the Commission to find that a merger must affirmatively be pro-competitive, that is, "the harms to competition – *i.e.*, enhancing market power, slowing the decline of market power, or impairing this Commission's ability properly to establish and enforce those rules necessary to establish and maintain the competition that will be a prerequisite to regulation -- are outweighed by benefits that enhance competition."[135]

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133 *See*, Applications of NYNEX Corporation and Bell Atlantic Corporation for Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries, File No. NSD-L-96-10, Memorandum Opinion and Order, 12 FCC Rcd 19985 (1997) ("NYNEX/Bell Atlantic Order"); Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorization Form; MediaOnce Group, Inc., Transferor, to AT&T Corp., Transferee, Memorandum Opinion and Order in CS Docket No. 99-25` (rel June 6, 2000).

134 *Id.* "Our examination of a proposed merger under the public interest standard includes consideration of the competition policies underlying the Sherman and Clayton Acts – the Commission is separately authorized to enforce Section 7 of the Clayton Act in the case of mergers of common carriers – but the public interest standard necessarily subsumes and extends beyond the traditional parameters of review under the antitrust laws."

135 See also, In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from; MediaOne Group, Inc., Transferor, To AT&T Corp. Transferee, Memorandum Opinion and Order in CS Docket No. 99-251 at para. 9 (rel. June 6, 2000), *SBC-Ameritech Order*, 14 FCC Rcd at 14736 P46 (1999); *WorldCom-MCI Order*, 13 FCC Rcd at 8031-32 P10 for discussion of Commission's duty weigh the potential public interest harms of the proposed merger against the potential public interest benefits to ensure that the Applicants have shown that, on balance, the benefits outweigh the harms.

In the first seven sections of this submission, Disney has reviewed the overwhelmingly anticompetitive effects of the proposed AOL/Time Warner acquisition. These profound concerns are compounded by the First Amendment implications of this transaction. Despite technological advances, the fundamental principle of diversity of voices must remain constant. However, the proposed AOL/Time Warner merger poses a very real threat to this tenet. It has the potential to reduce greatly the diversity of voices in the marketplace by thwarting the free flow of information from a variety of independent sources. If consumers cannot easily access sources of news and information unaffiliated with AOL/Time Warner, First Amendment values are undermined. Indeed, "[a]ssuring that the public has access to a multiplicity of information sources is a governmental purpose of the highest order, for it promotes values central to the First Amendment."[136]

In discharging its statutory obligation, the Commission cannot approve the AOL/Time Warner merger based upon the record now before it unless it is conditioned upon compliance with meaningful and enforceable safeguards that protect consumers from the attendant deprivation of access and denial of choice that is likely to result from this merger. The Commission possesses the requisite legal authority to impose such conditions. "Where necessary, the Commission can attach conditions to a transfer of licenses and authorizations in order to ensure that the public interest is served by the transaction."[137] In the past, the Commission has not refrained from imposing a broad array of conditions tailored to fit a

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136 *Turner Broadcasting Systems, Inc. v. FCC*, 51 U.S. 622, 663 (1994).

137 In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from; MediaOne Group, Inc., Transferor, To AT&T Corp. Transferee, Memorandum Opinion and Order in CS Docket No. 99-251 at para. 13 (rel. June 6, 2000) . See 47 C.F.R. @ 1.110; see also WorldCom-MCI Order, 13 FCC Rcd at 18031-32 P10; Bell Atlantic-NYNEX Order, 12 FCC Rcd at 20001-02 P30.

specific transaction to ensure that an individual transaction complies with existing law and is procompetitive.

For example, the Commission recently conditioned its approval of the AT&T/Media One merger on compliance with a number of procompetitive requirements necessary to protect consumers.[138] The Commission's approval of this merger was contingent on the merged AT&T/Media One agreeing to separate its ownership of some content and conduit by choosing to divest their interests in Time Warner Entertainment ("TWE"), to terminate their involvement in TWE's video programming activities or divest their interest in other cable systems. AT&T was prohibited from involving itself in the programming activities of TWE. AT&T and TWE were prohibited from exchanging information regarding the prices, terms and conditions negotiated for the carriage of video programming carried on their respective cable systems, and AT&T was prohibited from obtaining from any video programming vendor a volume discount or other favorable terms and conditions as a result of TWE's purchase of video programming for, or carriage on, TWE's cable systems. The Commission also imposed safeguards to prevent Liberty Media from influencing or participating in the video programming activities of AT&T. The Commission also conditioned its approval of the AT&T/Media One merger on compliance with numerous safeguards relating to Cablevision Systems and Rainbow Media Sports Holdings, Inc., the majority owned subsidiary of Cablevision Systems, such as prohibiting AT&T from participating in the management or operation of Rainbow. Finally, the Commission prohibited AT&T from having any role in the management or operation of IN

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[138] In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from; MediaOne Group, Inc., Transferor, To AT&T Corp. Transferee, Memorandum Opinion and Order in CS Docket No. 99-251 (rel. June 6, 2000)

DEMAND or the Media One video programming interests. Clearly, when the Commission perceives anticompetitive impacts, it has exercised its authority to impose specific conditions to ensure procompetitive results will flow from that merger. The Commission has confronted no proposed merger or acquisition which requires the imposition of strong and enforceable procompetitive conditions as much as the proposed AOL/Time Warner transaction.

IX. CONDITIONS THE COMMISSION SHOULD IMPOSE AS A PREREQUISITE TO ANY APPROVAL OF THE AOL/TIME WARNER ACQUISITION.

A. THE COMMISSION SHOULD REQUIRE AOL/TIME WARNER TO SEPARATE ITS OWNERSHIP OF CONTENT FROM ITS OWNERSHIP OF ITS BROADBAND CABLE DISTRIBUTION FACILITIES.

The most efficient and effective way for the Commission to protect consumer choice, ensure diversity of voices, and cure the anticompetitive problems of the AOL/Time Warner merger is simply to require the separate ownership of one of two main assets of the fused entity: the content or the conduit. The underlying principle of such a condition is this: if an entity is in a position to exercise monopoly or monopsony power in a market – in this case, gatekeeper control over the broadband pipeline and ownership of much of the content that will flow through that pipeline – then it is almost inevitable that the monopolist will favor its own content and disfavor unaffiliated content. This can occur in multiple ways, as we have seen from AOL's and Time Warner's past practices. First, the monopolist could favor its own content by denying the unaffiliated content provider access to its pipeline. Second, the monopolist could engage in discriminatory pricing schemes. Third, the monopolist could engage in technological discrimination to make what access it does provide to the unaffiliated content provider woefully inferior to its own. In essence, the monopolist could make it extremely difficult, if not impossible, for unaffiliated content providers to access the broadband pipeline on a commercially reasonable basis or for the public to enjoy the same Interactive Television