

# Let Them Eat Cable: Potential Sherman Act Liability when Media Giants Collaborate in Direct-to-Consumer Offerings

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## INTRODUCTION

Increasingly, consumers are foregoing their cable subscriptions in favor of direct-to-consumer streaming services like Netflix and Amazon. The result is a dramatic drop in revenues for media networks and cable companies that distribute their content. It is now beyond dispute that, in order to remain viable, traditional media companies have to employ some strategy to combat cord-cutting.

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NBCUniversal merged with telecommunications giant Comcast in 2009. Time Warner recently followed suit, merging with AT&T in early 2018. Disney has decided to launch their own streaming platform, which will no-doubt be bolstered by its recent acquisition of Fox (and prescient earlier acquisitions of Pixar, Marvel and LucasFilm). In the midst of so much merger and acquisition activity, the question then becomes: what about those companies left out in the cold? Those smaller media corporations that have not yet found a telecommunications giant to purchase them, or cannot conceivably adapt to a direct-to-consumer streaming model? Examples include Sony, Lionsgate, Viacom, CBS and AMC. Few would argue they possess enough content individually to launch streaming services that could compete with the likes of Disney+ or Netflix. CBS's All Access model only exists as a supplement to its cable offering, and would almost certainly be suffocated by the competition if it existed independently. Given the unsustainability of their position, one may ask why these "outlier" companies do not merge, or form a joint venture. The answer to the first question is relatively straightforward. A combination of any two of the companies listed would likely still not be sufficient to provide a viable streaming competitor. Any potential merger would have to include most, if not all of these companies, and multi-lateral mergers are exceedingly rare given that coordinating the interests of so many stakeholders generally proves impossible for even the most herculean negotiators. In answer to the second question, a joint venture is admittedly a more viable solution, but it comes with an inherent flaw, which forms the core dilemma this paper attempts to tackle. The flaw is this: in order to be a viable streaming competitor, such a joint venture would need to offer its content exclusively. This is because a streamer cannot expect consumers to pay for subscriptions if those consumers are able to view the same content elsewhere. In other words, exclusive control of popular content is key to the success of any streaming service. Under antitrust law, there is nothing prohibiting a joint streaming venture from creating new content and streaming it exclusively. However, when its members (who are ordinarily competitors) agree to withhold their independently created content (i.e. content not created by the joint venture) from other streamers, and choose instead to license it exclusively to the joint venture in order to give it the best chance for success, that may start to resemble a hub-and-spoke conspiracy and potentially subject them to antitrust liability. In general, under Section 1 of the Sherman Act, competitors may not agree (whether via a joint venture or otherwise) to withhold their product from certain customer/competitors in order to bolster their own market power. That would qualify as an agreement in restraint of trade. That is, unless such agreement falls within a recognized exception or there is otherwise a pro-competitive justification for such behavior.

In what follows, we argue that antitrust liability for a joint venture of this kind is in fact unlikely for two reasons: 1) there is sufficient case law to hold that, provided the JV envisaged does not require its members offer their content exclusively, it should not qualify as a hub-and-spoke conspiracy on its face and

2) regardless of the outcome of 1) above, the JV will likely be assessed and justified by the appropriate authorities in the context of broader industry trends such as direct-to-consumer offerings. As will be shown, antitrust law has adapted to similar forms of disruption in the past, most notably in the case of *Broadcast Music, Inc., v. Columbia Broadcasting System (“BMI”), Inc.* When one compares the broader market forces at play in that scenario with our current climate, the similarities are striking. We therefore conclude that, as with *BMI*, the joint venture in our case will likely be seen as pro-competitive and survive antitrust scrutiny.

### I. BACKGROUND

The late 70s and early 80s bore witness to the quantum leap which transformed the cable industry into the behemoth we might recognize today.<sup>1</sup> Using his credit card, an unemployed sports announcer named Bill Rasmussen rented airtime on a discounted RCA satellite. His goal was to provide 24 hour-a-day sports coverage via his newly created “Entertainment Sports Programming Network”. Struggling to remain afloat, ESPN then hired a shrewd management consultant named Roger Werner to develop a viable business strategy for the fledgling channel. Werner realized ESPN could not hope to cover its costs with advertising revenue alone, and would only survive if cable companies which distributed the network paid a small “carriage fee” for the privilege. It was a bold ask. Until that point, carriage fees<sup>2</sup> (if there were any) had flowed the other way – with networks paying cable companies to air their content. This radical departure from established practice was strongly resisted at first, but when CBS Cable—a network facing similar issues—folded in 1982, cable companies realized ESPN would be next. Not wishing to lose the highly popular network from their offerings, they acquiesced to a small fee. The dam was breached, and it was not long before virtually every network, spurred on by growing competition amongst cable companies, was requiring carriage fees. By 2002, ESPN was in 82 million households and was worth over \$20 billion – approximately 25% of holding company Disney’s market value.<sup>3</sup> It seemed as though the sky was the limit for cable television.

But in just the first quarter of 2017, the cable industry recorded a net loss

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1. This was preceded by an earlier quantum leap on the technological front – broadcasting content via satellite relay in 1975. Muhammad Ali and Joe Frazier are partly to thank for expediting this development, as their “Thrilla in Manila” was the first major television event to be shared via satellite. Impressed by the picture quality and potential cost savings involved, HBO soon began broadcasting all its content via that same satellite. They were quickly followed by Ted Turner’s WTBS and Sumner Redstone’s popular Viacom channels. Lynn Schafer Gross, *Cable Networks*, THE MUSEUM OF BROADCAST COMMUNICATIONS, <http://www.museum.tv/eotv/cablenetwork.htm> (last updated 2017) [<https://web.archive.org/web/20180712014340/http://www.museum.tv/eotv/cablenetwork.htm>].

2. Also called “affiliate” or “retransmission” fees.

3. *ESPN, Inc. History*, FUNDING UNIVERSE, <http://www.fundinguniverse.com/company-histories/espn-inc-history/> (citing *International Directory of Company Histories*, 56 ST. JAMES PRESS (2004)).

of 762,000 thousand consumers to the well-known phenomenon of “cord cutting”.<sup>4</sup> That represented almost as many customers as had been lost during the entire year of 2016 and a five-fold increase from the previous quarter year-on-year.<sup>5</sup> Cord-cutting, in other words, is accelerating, putting multichannel video programming distributors (“MVPDs”)<sup>6</sup> under pressure to reduce carriage fees paid to media companies.<sup>7</sup> Media company shareholders took notice. Disney and Fox’s share price fell almost 20% between 2015 and 2016,<sup>8</sup> while Viacom, AMC Networks and Discovery Communications’ are all trading at five-year lows.<sup>9</sup>

Most industry analysts agree that the “consumer’s *coup d’etat*” we are witnessing is long overdue.<sup>10</sup> How, then, did MVPDs and media companies find themselves in this vulnerable position? It appears, in essence, that for a long time they were, to varying extents, able to ignore the entertainment industry truism that “content is king”. MVPDs were spurred on by competition among themselves and began advertising the sheer number of networks they offered as their unique selling point.<sup>11</sup> At the same time, media companies were aware that

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4. Nick Perow, *Let Them Eat Cake: The Cord-Cutter’s Coup d’etat*, PRWEB (May 25, 2017), <http://www.prweb.com/releases/cut-the-cord/streaming-tv-bests-cable/prweb14351490.htm>. “Cord-cutting” and “cord-nevers” refers to the pressure cable companies are coming under on two fronts: (i) significantly deflated new-subscriber numbers, and (ii) accelerating losses of already-existing subscribers. Until quite recently – as late as the mid-2000s – the cable industry had proved resilient to the disruptive effects of the information revolution. Then several things happened, seemingly all at once. Internet bandwidth capabilities increased sufficiently to allow streaming of uninterrupted, high-definition video. This allowed companies like Netflix to move to a streaming model, with their content now accessed over the internet. Technology companies like Apple and Roku quickly developed new “over the top” (OTT) set top boxes to allow internet access direct to one’s TV, while TV manufacturers incorporated this technology in new models of “smart TV’s”). Before long, all of our favorite TV shows and movies were available OTT, whenever we wished to view them. No longer were consumers penned in to a programming “schedule”, but instead began making programming decisions themselves. With these advantages, and dramatically reduced prices, statistics show that many millennials have decided never to get a cable subscription, while many others are choosing to cancel theirs.

5. *Id.*

6. Throughout this article we will refer to “media companies” and “MVPDs”. MVPD is the technical term for traditional cable and satellite-cable companies such as Comcast, DirecTV and Dish. Their primary source of income is in the form of cable subscriptions from the public. MVPDs compete with each other on price, technological improvements (such as Dish’s “Hopper” function) and, most importantly, the content they offer. “Media companies”, on the other hand, refers to those large corporations which own content, traditionally in the form of networks. These include Viacom (whose properties include MTV and Comedy Central) and Disney (including ABC and ESPN). Their primary sources of revenue is billions of dollars’ worth of “carriage” or “affiliate fees” from MVPDs for the privilege of screening their content, along with advertising revenue.

7. Cynthia Littleton & Daniel Holloway, *TV’s Dead Zone: How the Cable Sector is Killing Off Struggling Networks*, VARIETY (March 21, 2017), <http://variety.com/2017/tv/features/overcrowded-cable-sector-esquire-spike-fyi-1202012647/>.

8. *Cutting the Cord: Television is at Last Having its Digital Revolution Moment*, THE ECONOMIST (Jul. 16, 2016), <https://www.economist.com/news/business/21702177-television-last-having-its-digital-revolution-moment-cutting-cord>.

9. *Id.*

10. See Perow, *supra* note 6.

11. Historically there is very little to distinguish cable companies from their competitors.

MVPDs could not afford to forego certain “must-have” content.<sup>12</sup> Media companies leveraged that power by tying must-have content to lower budget, generally unpopular programming and requiring MVPDs license the whole package of networks they offered.<sup>13</sup> MVPDs passed the added cost of these extra networks on to consumers, saddling them with a glut of channels, most of which lacked any broad appeal, and at ever increasing subscription fees.<sup>14</sup> Moreover, it appears that competition amongst MVPDs was half-hearted at best, many choosing to enjoy oligopolistic prices.<sup>15</sup> Consumer resentment built and this profitable industry became ripe for disruption.<sup>16</sup>

Unlike traditional cable companies, providers like Netflix are not under the same pressure to fill the hours of the day with a glut of channels. The new technology transferred “scheduling” decisions to the consumer who can choose what shows or movies they want to watch at whatever time they wish. Accordingly, when licensing content, Netflix did not need to license whole networks but rather selected individual movies and TV shows. Industry terminology labels this transition as one from “linear” to “non-linear” programming. Netflix was thereby able to avoid the expensive “package” deals that stymied MVPDs and drove up the price of cable subscriptions. It is little wonder, then, that a current monthly Netflix subscription costs just \$13.99, compared to roughly \$40 for the most competitive MVPD skinny bundle. Avoiding media package deals further allowed Netflix to focus on licensing programming its consumers actually wanted to see, while simultaneously investing in original content. That is not to say content on Netflix is necessarily higher in quality than on MVPDs, but rather that, in the new model, poor-quality

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FCC mandated program access rules (which were allowed to expire in 2012) required media companies to make certain “must have” networks available to more than one major MVPD, while technological differences between the services remained negligible. *See* Joe Flint, *FCC lets program access rules expire*, L.A. TIMES (Oct. 5, 2012), <http://articles.latimes.com/2012/oct/05/entertainment/la-et-ct-fcc-program-access-20121005>.

12. Bill Gurley, *Here's How the TV Business Actually Works (And Why It's Going to Take Longer Than You Think To Disrupt It)*, BUSINESS INSIDER (April 30, 2010), <http://www.businessinsider.com/heres-how-the-tv-business-actually-works-and-why-its-going-to-take-longer-than-you-think-to-disrupt-it-2010-4>. ESPN, which owns the rights to air certain live sporting events, is probably the clearest example of a “must have” network, as large numbers of consumers would abandon any MVPD which did not air ESPN. Angela Yang, *ESPN Ranks as a “Must Have” and Top Five Favorite Network in Annual Beta Cable Subscriber Study*, ESPN (Sept. 13, 2017), <https://espnpressroom.com/us/press-releases/2017/09/espn-ranks-must-top-five-favorite-network-annual-beta-cable-subscriber-study/>.

13. *Id.*

14. Jeanie Wyatt, *Cutting the Cord: On the Disruption of the Cable TV Industry*, RIVARD REPORT (Dec. 5, 2016), <https://therivardreport.com/cutting-the-cord-on-the-disruption-of-the-cable-tv-industry>. Of the 200+ channels available to them, the more adventurous consumers only watched an average of 17.5 per week, while their fees supported the entire bundle. Between 2011 and 2015 alone, the average fee for cable subscriptions increased by thirty-nine percent.

15. *See* Gurley, *supra* note 14.

16. The carriage fee model is still hugely profitable, worth over \$40 billion in 2016. *See* Littleton & Holloway, *supra* note 9. It is, however, on the inevitable decline, 2017 proving a watershed year as the pace of cord-cutting increased five-fold. *See* Perow, *supra* note 6.

content is easily bypassed by consumers and is soon dropped from the service. It is survival of the fittest content, the consumer being the ultimate beneficiary.

## II. SURVIVING THE RISE OF DIRECT-TO-CONSUMER SERVICES

### A. *Direct-to-Consumer, Vertical and Horizontal Integration*

Both media and MVPD giants have responded to the upheaval of cord-cutting in varying ways. In a prescient move, The Walt Disney Company announced that it will be withdrawing all its content from Netflix by 2019 to launch its own streaming service, presumably in direct competition with its former customers.<sup>17</sup> Disney – the largest of the media companies across virtually every metric – is perhaps one of the few companies with this option available to them. Services like Netflix and Amazon are daunting competitors, but with assets such as LucasFilm, Pixar and Marvel, not to mention its prolific library, Disney will likely have enough engaging content for a viable direct-to-consumer service.<sup>18</sup> With Disney’s acquisition of 20<sup>th</sup> Century Fox now approved, its stable of content has grown to astronomic heights and, as discussed later, all but insures their foray into streaming will be successful.

Another avenue showing some signs of success is the introduction of the “skinny bundle” by traditional MVPDs. Charlie Ergen’s Dish Network was the first to employ this option in earnest with the creation Sling TV. The skinny bundle is simply a reduced cable package, presumably featuring the networks consumers actually want to watch, and at a reduced price.<sup>19</sup> This “admission of guilt” by MVPDs is still seen by many as a swan song of the old business model. At four times the price of its streaming rivals, for much of the same content, even this reduced package is struggling to remain competitive.

Vertical mergers are another option, as media companies join with MVPDs, bridging the traditional divide between their industries in the hopes of revealing synergies. In 2009, Comcast achieved the largest successful example of this to date when it acquired media giant NBCUniversal in 2009. AT&T recently pursued a similar route, acquiring Time Warner in what is now the largest merger the media industry has seen.<sup>20</sup> For telecom companies, scaling up content ownership makes sense as a means of drawing more subscribers to their other

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17. Michelle Castillo, *Disney will pull its movies from Netflix and start its own streaming services*, CNBC (Aug. 9, 2017), <https://www.cnbc.com/2017/08/08/disney-will-pull-its-movies-from-netflix-and-start-its-own-streaming-services.html>. Shares in Netflix dropped more than five percent after Disney’s announcement.

18. See Jacob Kastrenakes, *Disney to end Netflix deal and launch its own streaming service*, THE VERGE (Aug. 8, 2017), <https://www.theverge.com/2017/8/8/16115254/disney-launching-streaming-service-ending-netflix-deal>.

19. The reduced price is about \$40 at the moment. Crayton Harrison & Chloe Whiteaker, *Here’s Why Skinny TV is Still an Experiment for Companies*, BLOOMBERG (May 3, 2017), <https://www.bloomberg.com/graphics/2017-skinny-bundle-television/>.

20. See *AT&T to Acquire Time Warner*, AT&T (Oct. 22, 2016), [http://about.att.com/story/att\\_to\\_acquire\\_time\\_warner.html](http://about.att.com/story/att_to_acquire_time_warner.html).

services. It was this same reason many forayed into the MVPD market in the first place. Acquiring the content companies which used to supply those MVPDs is the next logical step. Media companies, also under pressure as streamers invest more and more in original content, like this approach because of the sheer size and diversified holdings of the companies acquiring them. As such, with huge growth in the internet and telecommunications business, media companies owned by telecom giants find themselves less exposed to the sea change taking place in the television industry.<sup>21</sup>

Yet another option are horizontal mergers between media companies. With Disney's recent acquisition of Fox it is now able to restrict all content previously owned by Fox from reaching its streaming competitors.<sup>22</sup> Viacom and CBS are also currently exploring a merger in an attempt to reunify the National Amusements – controlled companies.

### *B. Challenges to Vertical and Horizontal Integration*

As discussed, carriage fees, which proved a boon to media companies for so long, are on the inevitable decline. In response, media companies are generally seeking to prolong their viability in one of three ways: (1) partnering up with MVPD counterparts, (2) merging with competitors in the media sphere, or (3) (and only where possible) launching their own streaming services in an effort to “become Netflix before Netflix becomes them”.<sup>23</sup> It appears that the first two options are not ideal and, as discussed, the third alternative is only possible for the largest media companies.

The first problem with mergers in general – whether vertical or horizontal – is autonomy. All things being equal, companies would prefer to be independent, and merging destroys this independence. The second problem facing mergers in general is the antitrust concern of market saturation. As noted, horizontal mergers, like exemplified by Disney and Fox, appear to be the most effective response to competition from streamers. But horizontal mergers can have a profound effect on market concentration and thus give rise to more significant antitrust scrutiny.<sup>24</sup> Vertical mergers, despite some recent uproar,<sup>25</sup>

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21. See Cynthia Littleton, *Comcast Q3 Earnings Beat Expectations Despite 134,000 Cable Subscriber Loss*, VARIETY (Oct. 26, 2017, 4:29 AM), <https://variety.com/2017/biz/news/comcast-nbcuniversal-q3-earnings-1202599711/>.

22. See *Texaco Inc. v. Dagher*, 547 U.S. 1, 7 (2006) (holding that a joint venture, once approved, is able to act within the “single entity rule” and may restrict supply of its products to competitors).

23. In a now infamous 2013 interview with Netflix's head-of content Ted Sarandos in GQ Magazine, he stated candidly that their ambition was to “become HBO faster than HBO can become us”. His comments were, for the most part, treated with mild skepticism. Nancy Hass, *And the Award for the Next HBO Goes to . . .*, GQ.com (Jan. 29, 2013), <https://www.gq.com/story/netflix-founder-reed-hastings-house-of-cards-arrested-development>.

24. This makes them more complex from a legal standpoint, as there has been no successful court challenge of a DOJ merger decision. This is largely because of the government-favorable precedent set out in *United States v. Vons*, 384 U.S. 270 (1996).

25. *Cont'l T. V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, (1977).

affect the concentration of the market far less, and as such are much simpler from a legal perspective. The third problem is one of economics. A merger between any two of the companies “left out in the cold” would likely be insufficient to provide a viable streaming competitor. In order to be practical, a merger would have to include almost all of the remaining media companies. The administrative burden of such a move, let alone the fact that a five or six way merger has never occurred across any industry, is too prohibitive to overcome. Yet market commentators note that vertical mergers with MVPDs effectively “kick the can down the road” as, until they commit to a direct to consumer offering, the problem of competing with the likes of Netflix remains. This begs the question: is there any way for the “smaller” media companies to retain their independence and yet still survive the inevitable decline of carriage fees?

### III. THE JOINT VENTURE: A POSSIBLE SOLUTION

On their own, less dominant media companies could not hope to replicate Disney and launch their own streaming services. They simply do not possess enough quality content to entice a critical mass of customers to subscribe to yet another streamer. But through a joint venture (“JV”), these companies may be able to combine enough quality content to create a viable direct-to-consumer competitor.<sup>26</sup> In order to be feasible, however, this JV would need to retain the ability to stream content exclusively, much like Disney would be able to under the single entity rule.<sup>27</sup> Otherwise, consumers would merely access the same content elsewhere. Exclusivity in a JV made up of competitors, however, poses significant antitrust concerns. As discussed, this JV may resemble a hub and spoke conspiracy, with the JV acting as the hub, and the competitors as the spokes. This kind of JV could also resemble a tying arrangement; using its dominance in the content market to boycott competitors in the secondary, (distribution) streaming market. Having outlined the market forces at play, we now explore whether that hypothetical lifeline may nonetheless exist, i.e., whether existing media companies can combine forces to form a joint venture streaming service, and supply that JV with *exclusive* content, without infringing antitrust law.

### IV. POTENTIAL PARTNERS

Before exploring exactly how such a JV may survive antitrust scrutiny, we can ground the hypothetical in reality by envisaging which media companies would likely benefit from such an arrangement. It is worth emphasizing that this

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26. In fact, Hulu is one such joint venture, owned by Disney, 21<sup>st</sup> Century Fox, Time Warner and NBC Universal. Hulu’s owners, however, do not restrict content to other streaming services and are therefore not “boycotting” any downstream competitors. Disney’s move to restrict content to Netflix, while practicable under the single entity rule for its own streaming service, could conceivably incur liability through its stake in Hulu. And while the present discussion may have implications for that scenario as well, it is beyond our scope here.

27. See *infra* Section V.A.

analysis is based on the diminishing prospects for the current carriage fee business model, which at present is still profitable for most media companies.

Viacom enjoyed enormous success from the 80s through the early 2000s with networks such as MTV, Comedy Central, BET and Nickelodeon achieving almost unmatched success.<sup>28</sup> Viacom was also the slowest of the big media companies to begin courting one of the three “options for survival” outlined earlier.<sup>29</sup> Analysts agree this is the primary reason the company’s share price remains low relative to earnings.<sup>30</sup> Viacom, however, still owns significant intellectual property. With Paramount Pictures as one of its subsidiaries, it has access to that studio’s prolific archive which includes commercial hits such as the *Transformers*, *Mission Impossible*, and *Star Trek* franchises, not to mention classics such as *The Godfather* and *Indiana Jones* movies. With respect to non-scripted television, Viacom retains the rights to massive commercial hits such as *Jersey Shore*, *The Real World*, *Cribs* and *Pimp my Ride* through MTV. Similar to HBO, Viacom would also be able to offer “must watch” daily, weekly and yearly programming such as *The Daily Show*, *South Park* and the *BET Awards*. Furthermore, its Paramount Network (formally Spike TV) appears to be producing high quality scripted content in the vein of an HBO or Netflix. Nickelodeon content, meanwhile, would help round out their offering in the streaming sphere.<sup>31</sup> As such, it appears that for the greatest chance of success, the new streaming service would offer core Viacom brands which remain popular with the general public.

Although much smaller than Viacom, the remaining networks with any highly sought after content are AMC and Discovery Networks.<sup>32</sup> Of those offerings, AMC has shown a particular aptitude for critically acclaimed scripted TV – something Viacom has so far lacked – with hit series like *The Walking Dead*, *Breaking Bad*, and *Mad Men*. Although some suggest AMC has not been able to consistently replicate the success of these series,<sup>33</sup> they have nonetheless shown the wherewithal to create undeniably “must-have” TV. With the addition of Discovery Networks’ IP, which includes *Animal Planet* and *Discovery TV*

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28. Historians note that MTV in particular became, in many ways, the zeitgeist of a generation, transforming the music industry as much as it did the TV industry.

29. Reports surfaced in early 2018 that Viacom was exploring a potential merger with CBS, the media giant it split from in 2006.

30. Wall Street is fully aware that the carriage fee model is fast becoming antiquated. With this “writing on the wall”, it is punishing Viacom for not responding to the change quickly enough despite its present high earnings.

31. Outlined as such, some may argue that perhaps Viacom possesses enough quality content to launch a streaming service on its own. This may have been true as late as the early 2000s, when Viacom properties remained dominant and commercially successful, but with falling subscriber numbers across all its key networks, and with Paramount Pictures struggling to replicate the success of its franchise hits mentioned earlier, Viacom on its own would face an enormous task distinguishing itself from the likes of Disney, HBO and Netflix.

32. A&E, still a supplier of popular cable channels, is partly owned and controlled by the Walt Disney Company. Unless spun off as a requirement of Disney’s potential merger with 21<sup>st</sup> Century Fox, it would not be available for the JV we envisage.

33. Unlike, say, an HBO, which enjoys such success almost constantly.

programming, these networks along with Viacom would round out a comprehensive scripted and non-scripted television offering.

As mentioned, such a streaming service would need to retain the ability to restrict some or all of its content from streaming competitors, yet avoid antitrust liability in the process.

## V. THE NETFLIX CHALLENGE – SECTION I ANALYSIS

In order to illustrate the legal viability of the JV we anticipate here, it is instructive to imagine a streaming competitor challenging the proposed arrangement on antitrust grounds.<sup>34</sup> Although there are a few possible contenders, the competitor that stands to lose the most with increased streaming competition is arguably Netflix,<sup>35</sup> and is therefore the most likely to challenge its validity. In what follows we outline how a traditional challenge on antitrust grounds would likely play out, and certain arguments that can be made in defense of the JV at this stage. While certainly worth a try, such arguments are heavily fact-specific and only serve to reduce the risk of a court finding in favor of Netflix if the fact pattern closely matches the one described. Luckily, we explore a possible “exemption” in the next section, which is grounded in legal principle and ultimately a stronger argument. The strongest defense to an antitrust challenge would likely be one that combines the below fact pattern with the *BMI* exemption later discussed.

### A. Applicable Antitrust Law

The Sherman Act, in short, prohibits two main categories of conduct, in Section I and Section II, respectively. The law is, in its most basic form, a consumer protection statute designed to ensure that the market is truly deciding the one thing it should be most adept at deciding: price. The social ill that the law was designed to outlaw is consumer overpayment for goods and services. As a result, Section I prohibits agreements in restraint of trade. This has been interpreted to exclude agreements that are “ancillary” to an agreement otherwise not in restraint of trade—like non-compete clauses, which are perfectly legal under the doctrine. The Section does, however, prohibit *per se* any agreement that fixes price (including activity that is economically synonymous with price fixing, like unduly restricting demand and group boycotts).<sup>36</sup> Importantly, the *actus reus* at the core of a Section I violation is the agreement: with no

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34. The criminality of violations of the Sherman Act surely serve as a deterrent. However, because of the standard of proof, the private right of action, the incredible costs associated with defending such a law suit, this proves a helpful (and realistic) analytical tool.

35. Unlike Amazon, Netflix is not owned by any parent company and is therefore at grave risk of any depreciation in market share. It would likely aggressively challenge any proposed JV where constituent members offered their content exclusively.

36. Any “combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity is illegal *per se*.” *U.S. v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 223 (1940).

agreement, there is no crime or liability.<sup>37</sup> Thus, oligopolistic markets are not said to be illegal under the Sherman Act, despite the fact that participants in such markets enjoy super-competitive prices.

Conversely, true cartels that are formed for the purpose of raising prices but are unsuccessful in doing so (i.e., the combination does not have the market power to artificially inflate prices) are nonetheless illegal under the Sherman Act. However, because an *agreement* is necessary for antitrust liability under this Section, an individual (company or person), including a fully owned subsidiary, *when acting on its own*, is completely within its rights to set whatever price it wants for its own services or goods.<sup>38</sup> Accordingly, behavior that would otherwise be categorized as a *per se* violation of the antitrust laws may be legal in joint venture scenarios because of the procompetitive nature of the organization itself.<sup>39</sup> These rights, including so-called *Colgate* rights, apply to lawful joint ventures—which, because they are a single entity<sup>40</sup>, can also set its own prices, and engage in lawful boycotts.<sup>41</sup>

The limited question of whether the media companies in our case can pool their assets in the form of a joint venture<sup>42</sup> is a largely uninteresting legal question (and, as described in note 32 *supra*, has already been answered by the example of Hulu). The question, however, of whether the members can supply this new JV with *exclusive* content is more nuanced and forms the core of our analysis.<sup>43</sup>

#### B. Exclusivity as a “Condition”

If the anticipated JV makes the exclusive supply of content a *condition* of joining, it will be subject to significant antitrust scrutiny for two reasons. First, such an “exclusivity condition” may be used as a factor to infer that exclusivity is in fact the purpose of the JV. If such a finding is made, a court may label the

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37. *Id.* Unlike Section 2, there is no “attempt” language in Section 1. *Compare* 15 U.S.C. § 1 with 15 U.S.C. § 2 (2000).

38. *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919); *Copperweld v. Indep. Tube Corp.*, 467 U.S. 752, 770 (1984).

39. *See Texaco Inc. v. Dagher*, 547 U.S. 1 (2005); *Broadcast Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1 (1979); *Goldfarb v. Virginia State Bar*, 421 U.S. 773 (1975); *O’Bannon v. Nat’l Collegiate Athletic Ass’n*, 802 F.3d 1049 (9th Cir. 2015) (exempting professional organizations and leagues in some cases).

40. *Texaco Inc v. Dagher*, 547 U.S. 1, 7 (2006) (arguing that Joint Ventures are immune to Section I liability because they are a single entity); *but see Associated Press v. United States*, 326 US 1 (1945) (holding that the Association’s rules on who can become a member unreasonably restrict trade because existing organizations have “veto” power and can choose to keep competitors in their market from joining. The Association can have membership limitations, but they need to be narrowly tailored to those goals).

41. *Per se* rules against boycotts in the joint venture world are also bad policy, as it acts as a disincentive to the creation of joint ventures in the first place. Joint ventures are formed to offset the financial risk any individual firm would undertake to improve the market and the product. Requiring the firms that do join in the joint venture to allow their competitors to free ride in this situation is bad policy.

42. Throughout this paper, we will refer to this entity as the “Joint Venture” or “JV”.

43. *Toys-R-Us, Apple, Interstate Circuit.*

JV an orchestrated boycott in all but name. The second reason comes from the law and is not based on any inferences made by a finder-of-fact. *Associated Press* clearly held that the rules of any joint venture—specifically the rules on membership—needed to be narrowly tailored to their pro-competitive purpose. For example: in *Associated Press*, membership rules were such that the newspapers were permitted to join—and have access to all associated press articles—subject to the veto of any existing member. This worked out fine for the first newspaper in a given geographic region to seek membership in the Associated Press. However, a second or third newspaper in the same region could only join subject to the veto of *any* existing member, including those it directly competed with in the geographic region. Because access to the Associated Press archive was near-essential to competing in those markets<sup>44</sup>, that veto power meant that the first to get an AP membership could cripple any of its potential competition. The Courts did not accept that the purported explanation for such a membership policy (that Associated Press did not need large amounts of members from relatively small geographic markets, and in fact needed a way to keep such oversaturation from occurring). The Court argued, in essence, that the membership rule applied to *any* geographic market and applied to *any* potential member (whether they were the third newspaper in New York to seek membership or the seventieth) and was thus overbroad for its stated purpose. In so deciding, the Court held that the rules were anticompetitive, but did not require Associated Press to cease operating. Rather, the Court suggested that there was an alternative rule that would remove the ability to reduce competition in relevant markets.

Thus, the JV in our case can take this instruction and structure its membership policies appropriately such that it does not run afoul of this rule. Its membership policies should be narrowly tailored to the JV's pro-competitive purpose: to enable it to compete with the direct-to-consumer streaming model. If it can demonstrate that the purpose of the JV is not to drive competitors in the media market out of business, *Associated Press* would not apply. If exclusivity of content is not to be a precondition to joining the JV, the pro-competitive effect and purpose of the arrangement would be clear and there would be no *Associated Press* reason to restructure the arrangement.

### C. Demonstrating Collusion – An Evidentiary Problem

Because, as demonstrated, exclusivity cannot be written in as a condition in the formation documents, any litigant would have to prove that the parallel conduct—each member of the JV choosing to provide its content exclusively to the JV—is actually collusion. How to infer such an illicit agreement from parallel conduct like this is, at its core, an evidentiary problem. Because single

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44. Unless other newspapers were willing to send journalists all over the country to report on stories that they would otherwise have the ability to publish if they were a member, there is simply no substitute for access to the AP archive.

entities can act as they please, and because oligopolistic markets are not policed under the Sherman Act, it is necessary to plead and prove an agreement (tacit or otherwise) in order to succeed in a suit of this nature. This analysis turns on two fundamental questions: what is necessary to infer an agreement, and what is necessary to differentiate that behavior from otherwise legal parallel conduct?

An agreement in restraint of trade is not strictly limited to the “offer, acceptance, and consideration” requirements of a contractual agreement. Acceptance, by competitors, to participate in an anti-competitive plan is in and of itself sufficient to violate the law, even without prior agreement.<sup>45</sup> In practice, a defendant facing an antitrust suit of this nature would file a motion to dismiss. If the motion fails, defendants most often seek to reach a settlement. For plaintiffs to survive such a motion, they must allege enough facts to suggest a conspiracy, and that *the anticompetitive effect is not the result of equally-plausible, independently rational behavior or a pure oligopoly*.<sup>46</sup> This involves a showing of not just parallel conduct, but also those factors that make it more likely than not that collusion is occurring.<sup>47</sup> Those factors include: actions contrary to self-interest; the opportunity (of competitors) to communicate; and adopted common, facilitating practices<sup>48</sup> that assist firms in achieving price uniformity.<sup>49</sup>

#### D. Avoiding a Hub-and-Spoke Arrangement

A hub-and-spoke agreement is one instance where a facilitating entity allows for all of these practices to exist and, as discussed, is illegal per se. When Apple attempted to compete on the digital book platform with Amazon it became such a facilitating entity. Amazon was offering to sell digitized versions of books for a lower price than its competitor (Apple). It also happened to be a lower price than publishers felt was profitable. So, when Apple went to the publishers, and offered to sell those publisher’s e-books for \$14.99 and suggested that they refuse to sell to Amazon if it refuses to sell e-books for at least that much each and every publisher did exactly that. Apple allowed them to leverage power that they did not have before by overcoming their collective action problem. In return, Apple’s competitor would be unable to sell that digital content for less than what Apple was going to sell it for.

Importantly for antitrust prosecutors, without Apple’s involvement, this collective bargaining could not have occurred. If Amazon indicates to one publisher that it intends to sell any given publisher’s e-books for \$9.99 and they

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45. *Interstate Circuit, Inc. v. United States*, 306 U.S. 208 (1939).

46. *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 548 (2007) (emphasis added).

47. *See Blomkest Fertilizer, Inc. v. Potash Corp. of Sask.*, 203 F.3d 1028, 1033 (8th Cir. 2000).

48. Examples of facilitating practices include price protection or most favored nation clauses in contracts, advance public announcement of prices *See Ethyl Gasoline Corp. v. United States*, 309 U.S. 439, 450 (1940). *See also, United States v. Container Corp. of America*, 393 U.S. 333, 336-37 (1969).

49. *See Blomkest, supra* note 50, at 1033.

refuse, Amazon would decline to sell those e-book on their platform, it does not make individual business sense to refuse to deal in that situation. Because Apple provided the information to the publishers—they knew that their competitors were going to refuse to deal with Amazon—their bargaining power increased and Amazon in turn had to sell for the higher price. This facilitation on behalf of Apple allows courts to infer a horizontal agreement and strike down the conduct as illegal.

The lesson for our hypothetical JV is that the JV cannot facilitate each individual media companies' decision to do something that would otherwise not make business sense to do. Does it make business sense to pull content from other streaming services if, as an executive, you do not know if other media companies will do the same? We argue that it may.<sup>50</sup> Given the rapidly declining revenue from carriage fees, it stands to reason that profits from a streaming service will eventually, and perhaps soon, outpace earnings from MVPD carriage fees. Such profits would only be higher if the content that streamer offers is exclusive to that service, thereby drawing more customers.

#### *E. “Plus Factor” Analysis*

Even absent a hub-and-spoke agreement, Courts may still infer an illegal agreement based on the presence of certain “plus factors.” For example, where firms are interdependent, engage in activity that is a radical departure from what was the industry norm, and such behavior involves an extraordinary risk if only one firm engages in the departure, an agreement is most likely. However, where market conditions are such that the firms would engage in the behavior *regardless* of whether other firms engage in the behavior (meaning the behavior is individually rational) an agreement cannot be inferred.<sup>51</sup> In determining whether the JV falls into the first or second category turns on one question: could every media company that initially decides to participate in the JV decide, *at a point after* the JV was formed, to pull its content from other streaming services? That is, would the act of leaving the JV with exclusive licensing rights to a large percentage of content be deemed impermissible anticompetitive conduct? Perhaps no. The argument for such an exclusive scenario has a razor-thin margin of error.

Because intellectual property rights, in theory, confer a legal monopoly to content owners, it is arguable that each individual content owner could independently, and rationally, decide that content is more valuable to them if it

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50. The facts also suggest that these licensing decisions occur on a continual and regular basis, already. For example, Netflix is no longer licensed to stream Friday Night Lights, an immensely popular television show. The decision to pull that content from Netflix, we assume, was independently rational, and the decision on its own does not invite antitrust scrutiny.

51. Oligopolies, on the other hand, can achieve a higher than competitive price even absent collusion. Small number of firms, high barriers to entry, and fungible products are the hallmarks of oligopolistic markets.

is available on fewer services and therefore economically scarce.<sup>52</sup> Examples of this underlying rationale underpin all current licensing models. Media companies allow their Netflix licenses to expire each month (effectively pulling that content from that service), and streaming certain “premium” content, requires payment of an additional fee. So is it in each media company’s rational self-interest to exercise their intellectual property rights in this way? We suggest that it certainly could be an independently rational decision to provide a media company’s most valuable content exclusively to the new Joint Venture. This is ultimately a factual inquiry: does the amount of profit each media company stands to make from its share of the JV’s revenues exceed its ordinary distribution fees for such content, and would its share be that high regardless of whether the other members of the JV supply their content exclusively? Several factors lead us to think the answer for most members would be yes. First, not all content is fungible. As shown by the bidding war over the rights to remake *The Lord of the Rings* into a TV series, distributors will go to great lengths to secure “must-have” content. The truism remains: content is king. Accordingly, if one member possesses must-have content—and we suggest some do—it will likely make sense to supply it exclusively to the JV as subscription premiums would surely outpace carriage fees. Second, as market disruption takes its course and carriage fees become less profitable, this only becomes more true. As the entire premise of this paper suggests, carriage fees are on the inevitable decline.

## VI. THE BROADCAST MUSIC EXCEPTION

Fortunately for the hypothetical JV and its constituent members, it might not matter whether the content owners explicitly agree that they will license their content exclusively to the JV. The visual media industry is not the first – nor will it be the last – to experience antitrust hurdles when avoiding market disruption. Media companies can look to the music industry to find precedent for the position that this type of arrangement is not illegal at all as evidenced in the Supreme Court’s *Broadcast Music, Inc., v. Columbia Broadcasting System, Inc.* decision in 1979.

In order to appreciate the similar market forces at play in the music industry leading up to the *BMI* case, some factual background is necessary. From 1897 the law stated that “vested in the owner of a copyrighted musical composition was the exclusive right to perform the work publicly for profit.”<sup>53</sup> However, this right was not self-enforcing. Moreover, it proved impossible for copyright

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52. *Fashion Originators’ Guild, Inc. v. FTC*, 312 U.S. 457, 61 S. Ct. 703 (1941) (holding that individually, each clothing manufacturer could decide to withhold their goods from distributors, but agreeing with their competitors to do so is an unlawful horizontal restraint of trade); *Klor’s, Inc. v. Broadway-Hale Stores, Inc.*, 255 F.2d 214 (9th Cir. 1958) (finding that an agreement with just one firm, is per se unlawful); *Nynex Corp. v. Discos*, 525 U.S. 128, 119 S. Ct. 493 (1998) (finding no per se rule absent a horizontal agreement).

53. *Broad. Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1, 99 S. Ct. 1551, 1554 (1979).

owners to detect most unauthorized uses because performances were so numerous and fleeting, rendering enforcement ineffective.<sup>54</sup> In response, Victor Herbert and a handful of other composers banded together to form ASCAP in 1914 to more effectively enforce their rights. ASCAP was essentially organized as a “clearing-house” for copyright owners and users. As it operated in 1979, its members granted it nonexclusive rights to license performances of their works, and ASCAP in turn issued licenses and distributed royalties. Broadcast Music, Inc. (“BMI”) was founded in 1939, and operated in much the same way. Both organizations issue what are called “blanket licenses” which gives licensees the right to perform any and all of the compositions owned by the members or affiliates as often as they’d like for a predetermined fee. This works in much the same way that your Spotify subscription works – no matter how many different songs you play, and no matter how many hours of music you listen to, you pay the same flat rate every month. From 1940 to 1975, Columbia Broadcasting System (“CBS”) owned a blanket license from both ASCAP and BMI, but filed a lawsuit against both “JVs” in that year.<sup>55</sup> CBS argued, and the Court of Appeals agreed, that the price ASCAP and BMI decided to sell their blanket license for was nothing more than the copyright owners agreeing to set the price for their (theoretically competing) goods.

The Supreme Court rejected CBS’s argument and held that blanket licenses sold to television and radio networks were not *per se* illegal under the antitrust laws. In so holding, the Court threw a wrench into its long-standing jurisprudence that any “combination formed for the purpose and effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity is illegal *per se*.”<sup>56</sup> The Court stated that “literalness is overly simplistic and often overbroad” and compared the composers to “partners setting the price of their goods or services.”<sup>57</sup> Justice White went on to state that the term “price fixing” does not always mean literal “price fixing.” Instead, “price fixing” is a shorthand way of describing business behavior that is ‘plainly anticompetitive’ and likely without ‘redeeming virtue.’<sup>58</sup>

“As we recognized in *United States v. Topco Associates*, 405 U.S. 596, 607-08 (1972), ‘[i]t is only after considerable experience with *certain business relationships* that courts classify them as *per se* violations.’”<sup>59</sup>

Notably, the most convincing arguments for why the fixed price is justified in *BMI*, regardless of whose music is being performed or how much music is played, are the practicalities of the market. *BMI*, the Court said, was offering a

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54. *CBS v. Am. Soc’y of Composers*, 400 F. Supp. 737, 741 (S.D.N.Y. 1975).

55. *See Broad. Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1 (1979).

56. *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940).

57. *BMI*, 44 U.S. at 9.

58. *Id.* at 8; *see also Socony-Oil supra* note 38.

59. *Id.* at 10 (noting that while Justice White might have been correct that the *per se* rule is directed at business behavior that is so plainly anticompetitive that we presume there is no redeeming business (competitive) virtue, he intentionally blurs the line distinguishing behavior that resembles price fixing and should be *per se* illegal, from behavior that is, actually, price fixing).

new product addressing issues in a changed environment. This new product ensured that composers are able to sell their works “direct[ly] to the consumer,” eliminating consumers’ hassle associated with going to each composer, one-by-one, each time they wanted to play a song. The product was simply better, and consumers were willing to pay a premium for it.<sup>60</sup> This pro-competitive justification distinguishes *BMI* from *Apple*, where Apple arranged for competing e-book publishers to boycott other online sellers in favor of Apple’s online platform at a higher, uniform price. There, consumers of e-books would ultimately suffer higher prices for much the same goods. In the *BMI* case, BMI was so revolutionary that it became the “good” itself.

Applied to our facts, can it be said that a JV among incumbent media companies is revolutionary enough to be considered a novel “good”, as in *BMI*? Probably not. But can it be said that consumers will ultimately benefit from an additional competitor to the likes of Disney, Netflix and Amazon? Almost certainly yes. Accordingly, should a court choose to read the Sherman Act quite literally, as Justice White warned against, the potential JV in our case might be labelled a *per se* illegal group boycott. But as the majority of the Court in *BMI* noted, “easy labels do not always supply ready answers.” Should a court instead focus on the underlying context and rationale of *BMI*—disruptive market forces requiring a new business arrangement among would-be competitors in order to survive, and one that ultimately proved more beneficial to the end consumer—they would be well within existing precedent to hold that such a JV is lawful.

#### CONCLUSION

In 2010 Time Warner CEO Jeff Bewkes scoffed at the idea of competition from Netflix, stating: “It’s a little like, is the Albanian Army going to take over the world? I don’t think so.”<sup>61</sup> Seven years later Netflix (and the copycats like Amazon and Hulu it inspired) drove Time Warner to seek out a merger with AT&T in order to survive. But contrary to what many exponents of the information revolution may suggest, most media companies are far from naïve to the sea-change taking place in their industry. Disney caused back to back shockwaves when it announced, first, in late 2017, that it would be entering the streaming business, followed by a second announcement in early 2018 that it would be acquiring the majority of 20<sup>th</sup> Century Fox’s assets. If there had been rumblings before, the urgency of “scaling” as a method for tackling cord-cutting now became a roar. Since then, Time Warner’s sale to AT&T has been approved by the Department of Justice, while Viacom and CBS are in active merger talks—an attempt many believe designed to make the combined company more attractive to a potential purchaser like Verizon. The luddite’s mantra of “let them eat cable” appears, finally, to be coming to an end. But “scale-mania”, as some

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60. You can “play it [again for them], Sam.” *CASABLANCA* (Warner Bros. Entertainment 1942). They’ve already paid.

61. Tim Arango, *Time Warner Views Netflix as a Fading Star*, *The New York Times* (Dec. 12, 2010), <https://www.nytimes.com/2010/12/13/business/media/13bewkes.html>.

commentators have labeled it, entails losing control of your company and, in all-but the example of Disney, seems to merely kick the problem of cord-cutting down the road. Without a viable direct-to-consumer offering, scale for scale's sake treats, rather than cures, the illness. A joint venture among media companies into the direct to consumer field is a possible solution. In order to be viable, that venture would need to possess exclusive content from its constituents. Exclusivity invites antitrust scrutiny under Section 1 of the Sherman Act. However, as shown here, antitrust concerns are potentially less serious than many may have thought. Provided each constituent could rationally refuse content to competitor streaming services and provide it only to the JV streaming service itself, the proposed JV could likely be approved under a traditional antitrust analysis. That said, even if the facts differ from those described here, it appears the BMI case may provide the perfect exemption to antitrust liability for the proposed JV, which operates in market conditions which largely mirror those of BMI.