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A Preliminary Assessment of the Relative Antitrust Risk of a Comcast vs Disney Purchase of 21st Century Fox Assets

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As has been rumored in the press for a few weeks, Comcast announced it is considering making a renewed bid for a large chunk of Twenty-First Century Fox's (Fox) assets. Fox is in the process of a significant reorganization, entailing primarily the sale of its international and non-television assets. Fox itself will continue, but with a focus on its US television business.

In December of last year, Fox agreed to sell these assets to Disney, in the process rejecting a bid from Comcast. Comcast's initial bid was some 16% higher than Disney's, although there were other differences in the proposed deals, as well.

In April of this year, Disney and Fox filed a proxy statement with the SEC explaining the basis for the board's decision, including predominantly the assertion that the Comcast bid (NB: Comcast is identified as "Party B" in that document) presented greater regulatory (antitrust) risk.

As noted, today Comcast announced it is in "advanced stages" of preparing another unsolicited bid. This time,

> Any offer for Fox would be all-cash and at a premium to the value of the current all-share offer from Disney. The structure and terms of any offer by Comcast, including with respect to both the spin-off of "New Fox" and the regulatory risk provisions and the related termination fee, would be at least as favorable to Fox shareholders as the Disney offer.

Because, as we now know (since the April proxy filing), Fox's board rejected Comcast's earlier offer largely on the basis of the board's assessment of the antitrust risk it presented, and

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because that risk assessment (and the difference between an all-cash and all-share offer) would now be the primary distinguishing feature between Comcast's and Disney's bids, it is worth evaluating that conclusion as Fox and its shareholders consider Comcast's new bid.

In short: There is no basis for ascribing a greater antitrust risk to Comcast's purchase of Fox's assets than to Disney's.

Summary of the Proposed Deal

Post-merger, Fox will continue to own Fox News Channel, Fox Business Network, Fox Broadcasting Company, Fox Sports, Fox Television Stations Group, and sports cable networks FS1, FS2, Fox Deportes, and Big Ten Network.

The deal would transfer to Comcast (or Disney) the following:

- Primarily, international assets, including Fox International (cable channels in Latin America, the EU, and Asia), Star India (the largest cable and broadcast network in India), and Fox's 39% interest in Sky (Europe's largest pay TV service).
- Fox's film properties, including 20th Century Fox, Fox Searchlight, and Fox Animation. These would bring along with them studios in Sydney and Los Angeles, but would not include the Fox Los Angeles backlot. Like the rest of the US film industry, the majority of Fox's film revenue is earned overseas.
- FX cable channels, National Geographic cable channels (of which Fox currently owns 75%), and twenty-two regional sports networks (RSNs). In terms of relative demand for the two cable networks, FX is a popular basic cable channel, but fairly far down the list of most-watched channels, while National Geographic doesn't even crack the top 50. Among the RSNs, only one geographic overlap exists with Comcast's current RSNs, and most of the Fox RSNs (at least 14 of the 22) are not in areas where Comcast has a substantial service presence.
- The deal would also entail a shift in the companies' ownership interests in Hulu. Hulu is currently owned in equal 30% shares by Disney, Comcast, and Fox, with the remaining, non-voting 10% owned by Time Warner. Either Comcast or Disney would hold a controlling 60% share of Hulu following the deal with Fox.

Analysis of the Antitrust Risk of a Comcast/Fox Merger

According to the joint proxy statement, Fox's board discounted Comcast's original \$34.36/share offer — but not the \$28.00/share offer from Disney — because of "the level of regulatory issues posed and the proposed risk allocation arrangements." Significantly on this basis, the Fox board determined Disney's offer to be superior.

The claim that a merger with Comcast poses sufficiently greater antitrust risk than a purchase by Disney to warrant its rejection out of hand is unsupportable, however. From an antitrust perspective, it is even plausible that a Comcast acquisition of the Fox assets would be on more-solid ground than would be a Disney acquisition.

Vertical Mergers Generally Present Less Antitrust Risk

A merger between Comcast and Fox would be predominantly vertical, while a merger between Disney and Fox, in contrast, would be primarily horizontal. Generally speaking, it is easier to get antitrust approval for vertical mergers than it is for horizontal mergers. As Bruce Hoffman, Director of the FTC's Bureau of Competition, noted earlier this year:

> [V]ertical merger enforcement is still a small part of our merger workload....
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> There is a strong theoretical basis for horizontal enforcement because economic models predict at least nominal potential for anticompetitive effects due to elimination of horizontal competition between substitutes.
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> Where horizontal mergers reduce competition on their face — though that reduction could be minimal or more than offset by benefits — vertical mergers do not.... [T]here are plenty of theories of anticompetitive harm from vertical mergers. But the problem is that those theories don't generally predict harm from vertical mergers; they simply show that harm is possible under certain conditions.

On its face, and consistent with the last quarter century of merger enforcement by the DOJ and FTC, the Comcast acquisition would be *less* likely to trigger antitrust scrutiny, and the Disney acquisition raises more straightforward antitrust issues.

This is true even in light of the fact that the DOJ decided to challenge the AT&T-Time Warner (AT&T/TWX) merger.

The AT&T/TWX merger is a single data point in a long history of successful vertical mergers that attracted little scrutiny, and no litigation, by antitrust enforcers (although several have been approved subject to consent orders).

Just because the DOJ challenged that one merger does not mean that antitrust enforcers generally, nor even the DOJ in particular, have suddenly become more hostile to vertical mergers.

Of particular importance to the conclusion that the AT&T/TWX merger challenge is of minimal relevance to predicting the DOJ's reception in this case, the theory of harm argued by the DOJ in that case is far from well-accepted, while the potential theory that could underpin a challenge to a Disney/Fox merger is. As Bruce Hoffman further remarks:

> I am skeptical of arguments that vertical mergers cause harm due to an increased bargaining skill; this is likely not an anticompetitive effect because it does not flow from a reduction in competition. I would contrast that to the elimination of competition in a horizontal merger that leads to an increase in bargaining leverage that could raise price or reduce output.

The Relatively Lower Risk of a Vertical Merger Challenge Hasn't Changed Following the DOJ's AT&T/Time Warner Challenge

Judge Leon is expected to rule on the AT&T/TWX merger in a matter of weeks. The theory underpinning the DOJ's challenge is problematic (to say the least), and the case it presented was decidedly weak. But no litigated legal outcome is ever certain, and the court could, of course, rule against the merger nevertheless.

Yet even if the court does rule against the AT&T/TWX merger, this hardly suggests that a Comcast/Fox deal would create a greater antitrust risk than would a Disney/Fox merger.

A single successful challenge to a vertical merger — what would be, in fact, the first successful vertical merger challenge in four decades — doesn't mean that the courts are becoming hostile to vertical mergers any more than the DOJ's challenge means that vertical mergers suddenly entail heightened enforcement risk. Rather, it would simply mean that that, *given the specific facts of the case*, the DOJ was able to make out its *prima facie* case, and that the defendants were unable to rebut it.

A ruling for the DOJ in the AT&T/TWX merger challenge would be rooted in a highly fact-specific analysis that could have no direct bearing on future cases.

In the AT&T/TWX case, the court's decision will turn on its assessment of the DOJ's argument that the merged firm could raise subscriber prices by a few pennies per subscriber. But as AT&T's attorney aptly pointed out at trial (echoing the testimony of AT&T's economist, Dennis Carlton):

> The government's modeled price increase is so negligible that, given the inherent uncertainty in that predictive exercise, it is not meaningfully distinguishable from zero.

Even minor deviations from the facts or the assumptions used in the AT&T/TWX case could completely upend the analysis — and there are important differences between the AT&T/TWX merger and a Comcast/Fox merger. True, both would be largely vertical mergers that would bring together programming and distribution assets in the home video market. But the foreclosure effects touted by the DOJ in the AT&T/TWX merger are seemingly either substantially smaller or entirely non-existent in the proposed Comcast/Fox merger.

Most importantly, the content at issue in AT&T/TWX is at least arguably (and, in fact, argued by the DOJ) "must have" programming — Time Warner's premium HBO channels and its CNN news programming, in particular, were central to the DOJ's foreclosure argument. By contrast, the programming that Comcast would pick up as a result of the proposed merger with Fox — FX (a popular, but non-essential, basic cable channel) and National Geographic channels (which attract a tiny fraction of cable viewing) — would be extremely unlikely to merit that designation.

Moreover, the DOJ made much of the fact that AT&T, through DirectTV, has a national distribution footprint. As a result, its analysis was dependent upon the company's potential ability to attract new subscribers decamping from competing providers from whom it withholds access to Time Warner content *in every market in the country*. Comcast, on the other hand, provides cable service in only about 35% of the country. This significantly limits its ability to credibly threaten competitors because its ability to recoup lost licensing fees by picking up new subscribers is so much more limited.

And while some RSNs may offer some highly prized live sports programming, the mismatch between Comcast's footprint and the FOX RSNs (only about 8 of the 22 Fox RSNs are in Comcast service areas) severely limits any ability or incentive the company would have to leverage that content for higher fees. Again, to the extent that RSN programming is not "must-have," and to the extent there is not overlap between the RSN's geographic area and Comcast's service area, the situation is manifestly not the same as the one at issue in the AT&T/TWX merger.

In sum, a ruling in favor of the DOJ in the AT&T/TWX case would be far from decisive in predicting how the agency and the courts would assess any potential concerns arising from Comcast's ownership of Fox's assets.

A Comcast/Fox Deal May Entail Lower Antitrust Risk than a Disney/Fox Merger

As discussed below, concerns about antitrust enforcement risk from a Comcast/Fox merger are likely overstated. Perhaps more importantly, however, to the extent these concerns are legitimate, they apply at least as much to a Disney/Fox merger. There is, at minimum, no basis for assuming a Comcast deal would present any *greater* regulatory risk.

The Antitrust Risk of a Comcast/Fox Merger Is Likely Overstated

The primary theory upon which antitrust enforcers could conceivably base a Comcast/Fox merger challenge would be a vertical foreclosure theory. Importantly, such a challenge would have to be based on the incremental effect of *adding* the Fox assets to Comcast, and *not* on the basis of its existing assets. Thus, for example, antitrust enforcers would not be able to base a merger challenge on the possibility that Comcast could leverage NBC content it currently owns to extract higher fees from competitors. Rather, only if the combination of NBC programming with additional content from Fox could create a *new* antitrust risk would a case be tenable.

Enforcers would be unlikely to view the addition of FX and National Geographic to the portfolio of programming content Comcast currently owns as sufficient to raise concerns that the merger would give Comcast anticompetitive bargaining power or the ability to foreclose access to its content.

Although even less likely, enforcers could be concerned with the (horizontal) addition of 20th Century Fox filmed entertainment to Universal's existing film production and distribution. But the theatrical film market is undeniably competitive, with the largest studio by revenue (Disney) last year holding only 22% of the market. The combination of 20th Century Fox with Universal would still result in a market share only around 25% based on 2017 revenues (and, depending on the year, not even result in the industry's largest share).

There is also little reason to think that a Comcast controlling interest in Hulu would attract problematic antitrust attention. Comcast has already demonstrated an interest in diversifying its revenue across cable subscriptions and licensing, broadband subscriptions, and licensing to OVDs, as evidenced by its recent deal to offer Netflix as part of its Xfinity packages. Hulu likely presents just one more avenue for pursuing this same diversification strategy. And Universal has a history (see, e.g., this, this, and this) of very broad licensing across cable providers, cable networks, OVDs, and the like.

In the case of Hulu, moreover, the fact that Comcast is vertically integrated in broadband as well as cable service likely reduces the anticompetitive risk because more-attractive OVD content has the potential to increase demand for Comcast's broadband service. Broadband offers larger margins (and is growing more rapidly) than cable, and it's quite possible that any loss in Comcast's cable subscriber revenue from Hulu's success would be more than offset by gains in its content licensing and broadband subscription revenue. The same, of course, goes for Comcast's incentives to license content to OVD competitors like Netflix: Comcast plausibly gains broadband subscription revenue from heightened consumer demand for Netflix, and this at least partially offsets any possible harm to Hulu from Netflix's success.

At the same time, especially relative to Netflix's vast library of original programming (an expected $8 billion worth in 2018 alone) and content licensed from other sources, the additional content Comcast would gain from a merger with Fox is not likely to appreciably increase its bargaining leverage or its ability to foreclose Netflix's access to its content.

Finally, Comcast's ownership of Fox's RSNs could, as noted, raise antitrust enforcers' eyebrows. Enforcers could be concerned that Comcast would condition competitors' access to RSN programming on higher licensing fees or prioritization of its NBC Sports channels.

While this is indeed a potential risk, it is hardly a foregone conclusion that it would draw an enforcement action. Among other things, NBC is far from the market leader, and improving its competitive position relative to ESPN could be viewed as a benefit of the deal. In any case, potential problems arising from ownership of the RSNs could easily be dealt with through divestiture or behavioral conditions; they are extremely unlikely to lead to an outright merger challenge.

The Antitrust Risk of a Disney Deal May Be Greater than Expected

While a Comcast/Fox deal doesn't entail *no* antitrust enforcement risk, it certainly doesn't entail sufficient risk to deem the deal dead on arrival. Moreover, it may entail *less* antitrust enforcement risk than would a Disney/Fox tie-up.

Yet, curiously, the joint proxy statement doesn't mention any antitrust risk from the Disney deal at all and seems to suggest that the Fox board applied *no* risk discount in evaluating Disney's bid.

Disney — already the market leader in the filmed entertainment industry — would acquire an even larger share of box office proceeds (and associated licensing revenues) through acquisition of Fox's film properties. Perhaps even more important, the deal would bring the movie rights to almost all of the Marvel Universe within Disney's ambit.

While, as suggested above, even that combination probably wouldn't trigger any sort of market power presumption, it would certainly create an entity with a larger share of the market and stronger control of the industry's most valuable franchises than would a Comcast/Fox deal.

Another relatively larger complication for a Disney/Fox merger arises from the prospect of combining Fox's RSNs with ESPN. Whatever ability or incentive either company would have to engage in anticompetitive conduct surrounding sports programming, that risk would seem to be more significant for undisputed market leader, Disney. At the same time, although still powerful, demand for ESPN on cable has been flagging. Disney could well see the ability to bundle ESPN with regional sports content as a way to prop up subscription revenues for ESPN — a practice, in fact, that it has employed successfully in the past.

Finally, it must be noted that licensing of consumer products is an even bigger driver of revenue from filmed entertainment than is theatrical release. No other company comes close to Disney in this space.

Disney is the world's largest licensor, earning almost $57 billion in 2016 from licensing properties like Star Wars and Marvel Comics. Universal is in a distant 7th place, with 2016 licensing revenue of about $6 billion. Adding Fox's (admittedly relatively small) licensing business would enhance Disney's substantial lead (even the number two global licensor, Meredith, earned less than half of Disney's licensing revenue in 2016). Again, this is unlikely to be a significant concern for antitrust enforcers, but it is notable that, to the extent it *might* be an issue, it is one that applies to Disney and not Comcast.

Conclusion

Although I hope to address these issues in greater detail in the future, for now the preliminary assessment is clear: There is no legitimate basis for ascribing a greater antitrust risk to a Comcast/Fox deal than to a Disney/Fox deal.