January 19, 2018

Disney-Fox Transaction

On December 14, 2017, the Walt Disney Company (Disney) and 21st Century Fox Inc. (Fox) announced that they have entered into an agreement under which Disney will acquire Fox for $66.1 billion. The price includes $52.4 billion for Fox's stock and the assumption of $13.7 billion of debt. Prior to the transaction, Fox will spin off certain assets into a new company.

After the transaction, Fox shareholders will own about 25% of Disney's stock. According to press reports, the family of Fox's current co-executive chairman, Rupert Murdoch, will own about 5% of Disney's stock. Mr. Murdoch's son, Lachlan, is also co-executive chairman of Fox, and his son, James, is the chief executive officer.

In the event federal regulators block the transaction, Disney has agreed to pay Fox a $2.5 billion breakup fee. If either party pulls out of the transaction for nonregulatory reasons, it will owe the other $1.52 billion.

The Companies

Disney is a diversified international family entertainment and media enterprise. It owns and operates the ABC broadcast television network, broadcast radio networks, eight broadcast television stations, and four radio stations. In addition, Disney owns and operates cable networks such as ESPN and the Disney Channel; television studios; and movie studios. It has a 30% share of the Hulu online subscription video-on-demand service. The company also owns a record label (Walt Disney Records), produces live stage plays, operates theme parks, and licenses Disney's visual and literary properties.

Fox has several business units that compete with Disney. Fox owns and operates the FOX and MyNetwork broadcast television networks, as well as 28 broadcast television stations. In addition, Fox owns and operates cable networks including FOX News and Fox Business Network; 15 regional sports networks plus national sports networks Fox Sports 1, Fox Sports 2, and the Big Ten Network; FX, and National Geographic. Fox also owns television and movie studios and a 30% share of Hulu. Its other interests include 39% of the Sky subscription television service in Europe and 50% of the Endemol Shine Group, a global television production company.

Under the agreement, Fox will sell its television and movie studios, several of its cable networks (including FX, National Geographic, and the regional sports networks), and its Hulu stake to Disney. Fox will spin off its broadcast television networks and stations, its cable news networks, and national sports networks into a new publicly traded corporation.

Consumer and Industry Trends

Both the television and movie industries are in the midst of structural changes driven by a combination of competitive pressures, technological developments, and consumer preferences.

Television Viewing

Changes in the way consumers watch television are profoundly affecting the television industry. **Table 1** illustrates this trend. Growing numbers of households have dropped their cable or satellite services (known as multichannel video programming distributors, or MVPDs) or have chosen not to subscribe in the first place. Instead, many are subscribing to online services that provide video programming via the Internet. Even after the cost of separately purchasing broadband service, these alternatives, such as Hulu, Netflix, Amazon Prime Video, Sling TV, and DIRECTV NOW, can be less expensive for some viewers than MVPD services.

Table 1. Television Distribution Sources for Consumers

(% of U.S. television households)

	2014	2015	2016	2017
Broadcast only	10%	11%	12%	13%
Cable/satellite	88%	86%	85%	82%
Broadband only	2%	3%	4%	5%
Total TV households	115.5 million	116.4 million	116.4 million	118.4 million

Source: CRS analysis of data from the Nielsen Company.

Note: A "Broadband only" household has at least one operable TV/monitor that receives video exclusively via a broadband Internet connection instead of traditional means.

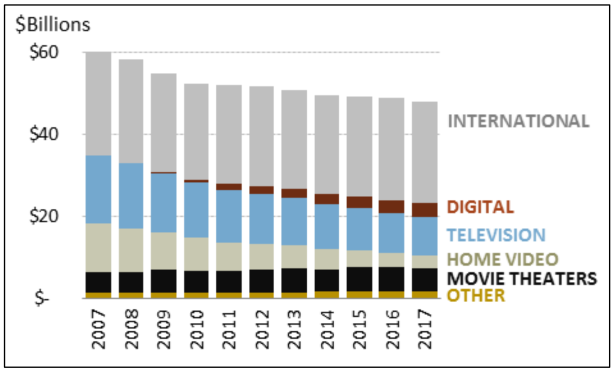
Consequently, MVPDs have lost subscribers. As subscriber numbers fall, cable networks such as Disney's ESPN and Fox's FX struggle to maintain their revenue from the MVPDs, which generally pay the networks on a per-subscriber basis to carry their programming. According to the research firm the Nielsen Company, the number of U.S. homes receiving ESPN dropped from 100 million in 2010 to 87 million in 2017. As fewer people watch the networks, the networks also lose revenue from advertisers, which pay them based on the number of viewers. Between the third quarters of 2016 and 2017, the operating income of Disney's cable networks declined 23%.

Studio Revenue

Likewise, over the last 10 years, U.S. consumers have substituted online subscription video services, particularly those that offer programming on an on-demand basis, for the rental and purchase of Blu-ray and digital video discs.

These services provide television and movie studios with large upfront payments for the rights to distribute movies and television programs. However, as **Figure 1** illustrates, the movie studios' revenue growth from digital licensing has not offset the loss in revenue from home video.

Figure 1. Movie Studio Revenue Sources



Source: CRS analysis of data from Derek Baine and Wade Holden, *The State of Home Entertainment*, S&P Global Market Intelligence.

Note: Categories are domestic (U.S.) unless otherwise noted.

One concern of both television and movie studios is that the online services serve as gatekeepers; they control proprietary viewing data and the presentation of the studios' content to subscribers. For example, Netflix relies on data it gathers about subscribers' viewing habits to suggest content to them, but may not share its data with studios, which have only a limited idea of how their content performs.

Disney Strategy

In view of these trends, in August 2017 Disney announced that it would end its distribution agreement with Netflix for new films, beginning in 2019. Instead, Disney is preparing to launch its own online video service in late 2019. Disney also plans to launch an ESPN-branded online video service with sports content in 2018. If the Disney-Fox transaction is consummated, Disney's online services could also include content currently controlled by Fox's studios and by several Fox cable networks.

On the day the companies announced the transaction, Disney Chairman and CEO Robert A. Iger stated that "we believe creating a direct-to-consumer relationship is vital to the future of our media businesses and is our highest priority." He added, "Should the multi-channel ecosystem get to the point where it is not as viable as it needs to be, we'd be well positioned to, in effect, flip a switch and distribute those programs and those channels directly to consumers through the platforms that we've created."

Potential Competitive Impact

Disney's acquisition of Fox's studios and cable networks would likely increase its power in negotiations with content distributors such as MVPDs, online video distribution services, and movie theaters. Government officials reviewing the transaction are likely to consider whether this would have implications for consumers.

Television Distribution

Disney negotiates the distribution of all of its networks as a single package. One competition concern is whether Disney could use its control over additional cable networks, in combination with its own online distribution services, as leverage to obtain higher fees from MVPDs or third-party online video services. Likewise, Disney might have the incentive and ability to withhold its content altogether and distribute it exclusively through its own streaming services. Disney's potential market power might drive MVPDs and online distributors to increase prices.

Movie Distribution

Research firm S&P Global estimates that in 2016, Disney's and Fox's movie studios' combined share of U.S. box office revenues was about 40%. Only two other major studios had domestic box office revenue shares above 10% during the last three years: Time Warner and NBCUniversal. After taking ownership of Fox's studio, Disney might be able to insist on a larger share of cinemas' box-office revenue from its films, or negotiate other favorable terms and conditions. This could potentially lead movie theaters to raise ticket prices and/or decrease the availability of films distributed by Disney competitors.

Antitrust Review

The Hart-Scott-Rodino Act requires parties to transactions of significant size to report them to the federal government and wait to consummate them while the government conducts a review. Accordingly, before this transaction can proceed, either the U.S. Department of Justice or the Federal Trade Commission will review it to determine whether it will substantially reduce competition, as prohibited by Section 7 of the Clayton Antitrust Act, which primarily governs merger reviews. Following the government's review, antitrust authorities may allow the deal to close as originally proposed. Alternatively, they may negotiate a consent agreement that includes provisions to maintain competition, or seek to stop the transaction.

Potential FCC Review

Pursuant to the Communications Act of 1934, the Federal Communications Commission (FCC) must determine whether any license transfers would, on balance, serve the public interest. If Disney is to acquire Fox's licenses to send cable programming signals to and from satellites, then the FCC would review the transaction.

In addition, if the FCC determines that the Murdoch family would have "cognizable interest" in Disney's licenses, it may review the transaction to determine if the Murdoch family's "control" of Disney broadcast stations would be in the public interest. FCC rules prohibit common ownership or control of two "top four" broadcast networks such as ABC and Fox, and also prohibit ownership or control of more than two stations within the same local market. If the Murdoch family is determined to "control" Disney, it would control more than two stations in five local markets.

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