UNITED STATES OF AMERICA
BEFORE FEDERAL TRADE COMMISSION

COMMISSIONERS: **Deborah Platt Majoras, Chairman**
Orson Swindle
Thomas B. Leary
Pamela Jones Harbour
Jon Leibowitz

In the Matter of **Time Warner Inc.,** **a corporation;** **Turner Broadcasting System, Inc.,** **a corporation;** **Tele-Communications, Inc.,** **a corporation; and** **Liberty Media Corporation,** **a corporation.**	**Docket No. C-3709**

ORDER REOPENING AND MODIFYING ORDER

On August 26, 2004, Liberty Media Corporation ("Liberty") filed with the Commission its "Petition of Respondent Liberty Media Corporation to Reopen and Modify" ("Petition") to modify the Commission's order In the Matter of Time Warner *et al.*, Docket No. C-3709 ("Order"). Liberty requests such reopening and modification pursuant to Section 5(b) of the Federal Trade Commission Act, 15 U.S.C. § 45(b), and Section 2.51 of the Commission's Rules of Practice and Procedure, 16 C.F.R. § 2.51. It asserts that such action is warranted on the grounds that the requested changes are "in the public interest and because changed circumstances relating to Liberty have arisen that are not expressly addressed by the Order." On September 3, 2004, the Commission placed on the public record Liberty's Petition and associated materials (with certain information redacted to protect confidential business information) and invited the public, for a period of 30 days, to submit comments on the Petition. No comments have been received. The Commission has reviewed the Petition and attached materials and has determined that certain changes in the Order are in the public interest for the reasons set forth below.

THE ORDER

On February 3, 1997, the Commission issued an order regarding Liberty's proposed acquisition of voting securities of Time Warner. That order resulted from Time Warner's 1996 acquisition of Turner Broadcasting, Inc. ("Turner"). Prior to that acquisition, Tele-Communications, Inc. ("TCI"), and its wholly owned subsidiary Liberty, had an approximately 24 percent interest in Turner. As a result of trading their interest in Turner for an interest in Time Warner, TCI and Liberty acquired approximately 7.5 percent of the fully diluted voting securities in Time Warner, valued at approximately $2 billion. (Complaint ¶ 21.) The Analysis to Aid Public comment on the Order noted, *inter alia*:

> The draft complaint . . . alleges that the acquisition, along with related transactions, would allow Time Warner unilaterally to raise the prices of cable television programming and would limit the ability of cable television systems that buy such programming to take responsive action to avoid such price increases. . . .

The Analysis further stated:

> In addition to the divestiture provisions ensuring that TCI [and Liberty] will have no incentive to forgo [their] own best interests in order to favor those of Time Warner, the proposed consent order contains provisions to ensure that the transaction will not leave TCI [or Liberty] or [their] management in a position to influence Time Warner to alter its own conduct in order to benefit TCI's [or Liberty's] interests.

Although the Order required that TCI and Liberty divest their Time Warner shares, the Order permitted TCI and Liberty to retain their Time Warner shares, subject to certain restrictions, if the Internal Revenue Service determined that the divestiture would be taxable. Because the IRS ruled that a divestiture would be a taxable event, TCI and Liberty have retained their Time Warner stock. Consequently, the Order imposes conditions on the type and amount of Time Warner shares that may be retained by TCI and Liberty.

The Order requirements relevant to this Petition concern the shares acquired by Liberty and are set forth in Paragraphs II(D)(1) and II(D)(2). Paragraph II(D)(1) limits the percentage of Time Warner shares that may be owned by Liberty and certain other parties while the Order is in effect. Those limits have not been exceeded. Paragraph II(D)(2) states that Liberty "shall not acquire or hold any Ownership Interest in Time Warner that is entitled to exercise voting power except [limited voting rights in circumstances not relevant here]. *Provided, however,* that any portion of [Liberty's] Interest in Time Warner that is sold to an Independent Third Party may be converted into voting stock of Time Warner." Paragraph I(W) defines "Ownership Interest" to mean "any right(s), present or contingent, to hold voting or nonvoting interest(s), equity interest(s), and/or beneficial ownership(s) in the capital stock of a Person."

THE TRANSACTIONS CONTEMPLATED BY LIBERTY

Liberty owns 171,185,826 shares of Time Warner, worth approximately $2.8 billion on August 4, 2004 (*see* Petition at 4), which have been stripped of all but the very limited voting rights provided for in the Order. Consequently, these shares shall be described in this order as nonvoting shares. Liberty desires to lend some or all of these shares pursuant to an agreement based on The Bond Market Association's "Master Securities Loan Agreement" ("Master Agreement"). (See Affidavit of Neal Dermer ("Affidavit") at ¶¶ 5, 6, 13.) The Master Agreement is attached to the Petition as Exhibit 4.

This type of securities loan agreement is designed to transfer to the borrowing person the share certificates and the rights to collect dividends or distributions attributable to the shares, to vote the shares, and to sell the shares. (Master Agreement at ¶ 7.) Thus, the borrower is free to relend the shares, to put them up as collateral, or to sell them. However, regardless of what the borrower does with the share certificates it has received, the borrower must make payments to the lender that are equal to any dividends or distributions attributable to the loaned shares (Master Agreement at ¶ 8) and, within three days of a request by the lender, must provide the lender with the number of shares borrowed from the lender. (Master Agreement at ¶ 6.) The borrower typically pays the lender a fee for the period it borrows the shares and may return the shares upon three days' notice to the lender. (Liberty has summarized its view of the characteristics of the loan agreement that it contemplates in Exhibit 2.)

The Certificate of Designations (Exhibit 1) that created Liberty's nonvoting Time Warner shares adds some unique aspects to the contemplated loans. The Certificate provides that these nonvoting shares may be held only by Liberty and other specified entities and that Time Warner will convert their nonvoting shares to voting shares if they are transferred to Independent Third Parties. (Exhibit 1 at ¶ 6.) In order to lend shares pursuant to the Master Agreement, Liberty will be required to surrender its Time Warner share certificates. Given the restrictions of ¶ 6 in the Certificate of Designations on who may hold nonvoting shares, the borrowed nonvoting shares will be delivered to Time Warner, which will issue voting shares to the borrower. Notwithstanding the issuance of replacement voting shares, Liberty will continue to list in filings with the Securities and Exchange Commission the shares it has loaned as assets of Liberty; that is, it will continue to assert ownership of the same number of nonvoting Time Warner shares. (Affidavit at ¶ 17.)

Liberty has provided the Commission with confidential copies of agreements that explain why it wishes to enter into a particular loan agreement that would include a portion of the Time Warner shares that it holds.[1] It has also requested the right to lend the remainder of its Time Warner shares, although it has no immediate plans to loan those shares. (Affidavit at ¶ 13.)

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[1] Exhibit 3 is redacted from the public version of the Petition.

THE ORDER DOES NOT PERMIT LIBERTY TO ENTER INTO THE CONTEMPLATED LOAN TRANSACTION

The contemplated loan agreement would result in Liberty's violating the prohibition on having "any Ownership Interest in Time Warner that is entitled to exercise voting power . . ." It is clear that Liberty will retain substantial interests in the voting securities that are loaned. As noted above, "Ownership Interest" is defined to include "beneficial ownership" – a term that the Commission discussed at some length in the Statement of Basis and Purpose ("Statement") for the regulations that promulgated the premerger notification rules.[2] Even though premerger notification reporting obligations apply only to persons who hold voting securities, the right to vote shares was not made the determinative factor in deciding ownership. Moreover, the Statement specifies that beneficial ownership is not determined by title to the shares or record ownership; rather, the Statement sets forth more general criteria, including

> the indicia of beneficial ownership, which include the right to obtain the benefit of any increase in value or dividends, the risk of loss of value, the right to vote the stock or to determine who may vote the stock, [and] the investment discretion (including the power to dispose of the stock).[3]

As noted above, Liberty will continue to enjoy the benefit of any increase in value of the shares because it retains the right to terminate the loan and then sell the returned shares. Even without terminating the loan, Liberty continues to be entitled to be paid the amount distributed as dividends on the loaned shares. Furthermore, Liberty retains the risk of loss in value of the shares because the borrower may terminate the loan and return the shares to Liberty. Liberty's power to recall the voting shares also includes the power to "dispose of the stock" (that is, to sell the shares). These multiple indicia of beneficial ownership are retained by Liberty and are more than enough to violate the "any Ownership Interest" standard set out in the Order.

Moreover, a securities loan agreement does not necessarily provide assurance that the lender will have no ability to control or influence the vote of the Time Warner shares by the borrower. Under the Master Agreement, the lender transfers the right to vote the loaned shares. That allocation of the right to vote is solely a consequence of Paragraph 7.1 of the contract. If that provision were modified, the vote might not be transferred or might be transferred with conditions. Even absent an explicit limitation on the borrower's right to vote, the right to terminate the loan might position the lender to influence the voting of the shares by threatening

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[2] Although the definitions in those rules do not restrict the way the Commission uses those terms in its orders, the definitions and Statement of Basis and Purpose are relevant where, as here, the purposes of using the terms are essentially similar. Here the question is what rights are relevant to ownership of voting securities where the title to the securities is held by a person that does not possess other rights that are normally associated with ownership.

[3] 43 Fed. Reg. 33450, 33458 (July 31, 1978).

to terminate the loan. The potential to influence the voting of shares is inconsistent with the purpose of the Order. In these circumstances, the Commission concludes that the contemplated loan agreement would violate the Order absent a modification.

NEVERTHELESS, THE PUBLIC INTEREST WARRANTS REOPENING AND MODIFICATION OF THE ORDER

Accordingly, we turn to Liberty's request for a modification of the Order.[4] Section 5(b) of the Federal Trade Commission Act, 15 U.S.C. § 45(b), provides that the Commission shall reopen an order to consider whether it should be modified if the respondent "makes a satisfactory showing that changed conditions of law or fact" so require. A satisfactory showing sufficient to require reopening is made when a request to reopen identifies significant changes in circumstances and shows that the changes eliminate the need for the order or make continued application of it inequitable or harmful to competition. S. Rep. No. 96-500, 96th Cong., 1st Sess. 9 (1979) (significant changes or changes causing unfair disadvantage); *Louisiana-Pacific Corporation*, Docket No. C-2956, Letter to John C. Hart at 4 (unpublished) (June 5, 1986) ("Hart Letter").[5] Liberty has not asserted that any changed condition of law requires reopening the Order, and therefore we have not considered that issue.

Section 5(b) also provides that the Commission may modify an order when, although changed circumstances would not require reopening, the Commission determines that the public interest so requires. Respondents are therefore invited in petitions to reopen to show how the public interest warrants the requested modification. Hart Letter at 5; 16 C.F.R. § 2.51. The Commission has described the showing needed to obtain a modification based on the public interest standard:

> [A] "satisfactory showing" requires, with respect to "public interest" requests, that the requester make a *prima facie* showing of a legitimate "public interest" reason or reasons justifying relief. . . . [T]his showing requires the requester to demonstrate, for example, that there is a more effective or efficient way of achieving the purposes of the order . . . .[6]

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[4] In its petition, Liberty states that it filed its Petition in order "to confirm that the Order does not prohibit loans of Time Warner stock." A party seeking "confirmation" that its intended action is lawful under the Order, however, should seek an Advisory Opinion of the Commission pursuant to 16 C.F.R. §§ 1.1-1.4. A petition to reopen and modify an order – such as Liberty filed here – is not a suitable vehicle for seeking such confirmation.

[5] *See also United States v. Louisiana-Pacific Corp.*, 967 F.2d 1372, 1376-77 (9th Cir. 1992) ("A decision to reopen . . . does not necessarily entail a decision to modify the order. Reopening may occur even when the petition itself does not plead facts requiring modification.").

[6] 65 Fed. Reg. 50636, 50637 (Aug. 21, 2000).

The language of Section 5(b) plainly anticipates that the burden is on the petitioner to make a "satisfactory showing" of changed conditions to obtain reopening of the order. The legislative history also makes clear that the petitioner has the burden of showing, other than by conclusory statements, why an order should be modified. The Commission "may properly decline to reopen an order if a request is merely conclusory or otherwise fails to set forth specific facts demonstrating in detail the nature of the changed conditions and the reasons why these changed conditions require the requested modification of the order." S. Rep. No. 96-500, 96th Cong., 1st Sess. 9-10 (1979); *see also* Rule 2.51(b) (requiring affidavits in support of petitions to reopen and modify). If the Commission determines that the petitioner has made the necessary showing, the Commission must reopen the order to consider whether modification is required and, if so, the nature and extent of the modification. The Commission is not required to reopen the order, however, if the petitioner fails to meet its burden of making the satisfactory showing required by the statute. The petitioner's burden is not a light one in view of the public interest in repose and the finality of Commission orders. *See Federated Department Stores, Inc. v. Moitie*, 452 U.S. 394 (1981) (strong public interest considerations support repose and finality).

Liberty argues that it has incurred unexpected expenses associated with the forward sale of some of its Time Warner shares and that these expenses warrant reopening and modifying the order. The bank to which it will sell these shares at a predetermined price requires Liberty to pay certain costs incurred by the bank in connection with the forward sale, but it would accept a loan of a specified number of shares in place of reimbursement. This asserted "change"of fact fails to meet the standard for reopening. The obligation to the bank does not "eliminate the need for the order" or "make continued application of it inequitable or harmful to competition." Liberty simply wants to use its shares to pay its bills or make money. The lack of connection between the forward sale and the requested modification is evident from the fact that Liberty wishes to be free to lend any and all of its Time Warner shares. However laudable the desire of Liberty to earn the highest return for its shareholders, it does not meet the test that favors repose and finality of orders.

Although the individual corporate interest of Liberty is not sufficient to warrant reopening this Order under the change of fact standard, the modification sought by Liberty will serve a broader public interest that does warrant reopening. The market for loaned securities benefits the broader securities markets by making them more liquid. Restricting the supply of shares that may be loaned reduces the liquidity of these markets and thereby may make them less efficient. Liberty holds about $2.8 billion worth of Time Warner shares. Preventing such a large holding of shares from participating in the market for Time Warner loaned securities could distort that market and make it less efficient; consequently, the public might benefit from removing the prohibition if the objectives of the Order can be achieved by a narrower, more efficient provision.

The Order provisions that Liberty seeks to have modified were designed to assure that Liberty could not vote its Time Warner shares directly or indirectly. That purpose can be achieved by modifying the Order to permit Liberty to lend its Time Warner shares while prohibiting it from retaining any right to vote those shares, to direct how those shares will be

voted, or directly or indirectly to influence or seek to influence the votes of those who borrow Liberty's Time Warner shares.

The modification ordered below incorporates most of the language proposed by Liberty. Liberty does not oppose the changes that the Commission has made to the language that Liberty proposed.

Accordingly, IT IS ORDERED that this matter be, and it hereby is, reopened; and

IT IS FURTHER ORDERED that Paragraph II(D)(2) of the Order be, and it hereby is, modified as of the effective date of this order, to add the following language:

> *Provided, further,* that this Paragraph II(D)(2) shall not prohibit the loan of any Time Warner stock, *provided that,* (i) during the term of the loan, the Person lending the stock has no right to vote the stock or to direct the voting of the stock and does not, directly or indirectly, influence or attempt to influence voting of the stock; (ii) any agreement, document or instrument pursuant to which the stock is loaned contains one or more provisions: (x) acknowledging that, during the term of the loan, the Person lending the stock has no right to vote or direct the vote of the loaned stock and will not, directly or indirectly, influence or attempt to influence the vote of the loaned stock and (y) recognizing that, during the term of the loan, the borrower of the stock has no obligation to respond to any request by the Person lending the stock concerning the voting of the stock; and, (iii) any stock loaned shall be considered to be held in its original form by the Person lending the same for purposes of determining whether such Person is in compliance with the provisions of Paragraph II(D)(1) of this order.

By the Commission, Chairman Majoras recused and Commissioner Leibowitz not participating.

Donald S. Clark
Secretary

SEAL:
ISSUED: December 21, 2004