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Cutthroat

High Stakes & Killer Moves on the Electronic Frontier

Stephen Keating

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It is a world in which competition is lauded as the basic axiom and guiding principle, yet too much competition is condemned as cutthroat.
Alan Greenspan, 1961

Contents

Prologue: The Game	ix
1. The Cable Gang Mourns	1
2. Deathstar	13
3. Stealing Free TV	35
4. The Chess Machine	59
5. Cutting Cable	81
6. The Rat Zapper	107
7. 500 Channels	121
8. Fighting for Air	139
9. Elvis Is in the Building	161
10. Angry Eyeballs	173
11. Calling Dr. Kevorkian	197
12. Summer of Love	215
13. Endgame	239
Epilogue: Survival of the Leveraged	267
Notes	277
Acknowledgments	305
Index	307

Prologue: The Game

The game is going on right now, all over the world. It requires no allies, just alliances. No team loyalties, just self-interest. Strategies form and dissolve with every play. A helping hand may bring a knife in the back. In the next round, the players switch sides and do it again.

Cutthroat is the name of the game on the electronic frontier.

Cable cowboys once lassoed broadcast TV signals into rural towns, then sought to strangle the broadcasters. Satellite TV aims a laser at both. Phone companies must connect the calls of competitors or die of isolation. The Internet is a vast, chaotic network that owes its nature to print, phone, broadcast, cable, satellites and computers, yet is something else entirely that may devour all of it.

Electronic media is an interlocked, trillion-dollar, global game that feeds on our insatiable desire to know, communicate and be entertained. The game is guided by technology, big money, regulation, demand and the artful savagery of media chiefs.

They need each other, as partners and suppliers. Yet they bleed each other as rivals and takeover targets. It all depends on the day, the deal and the leverage to get it done.

They're playing cutthroat in your home.

With such thievery and cross-purposes built into the game, who wins and who loses? What are the stakes? The rules?

The essence of the game is illustrated by one play.

In February of 1997, Rupert Murdoch, the Australian media pirate, and Charlie Ergen, a wily American hustler, announced plans to launch a killer satellite TV service nicknamed Deathstar. It lit up the sky, then fell to earth, undone by a cable mastermind named John Malone.

How these players and others came to be, the way that they clashed and what happened next is a view to the future of the electronic frontier.

One The Cable Gang Mourns

Outside the Church in suburban Denver were nine limousines, eight white and one black, disgorging men in dark suits. In a red-railed enclosure nearby, an Arabian stallion stood bridled in silver and leather, nibbling on a bale of hay.

Inside the First Church of the Nazarene, 1,000 people took their seats on hardwood pews, facing a stage covered with 750 white roses. On an easel was a large photo of a wiry Oklahoman named Bob John Magness, smiling, with a whistlin' gap between his teeth and a crow's beak of a nose. His cowboy hat hung from a corner of the picture frame. A Boy Scout color guard marched in with three flags, representing the United States of America, the state of Colorado, and the blue-and-purple corporate stripes of Tele-Communications, Inc., the world's most powerful cable TV company, known simply as TCI.

Beyond those in the church, including Ted Turner and other media executives from around the country, few people knew Magness. His death of cancer at age 72 in November of 1996, and life up to that point, occasioned little notice outside the industry. But through timing, perseverance and dumb luck, Magness had risen over four decades to head a colossus.

One in four cable subscribers signed a check each month to TCI

or its affiliates. TCI owned pieces of many networks, ranging from CNN to the Discovery Channel to Black Entertainment Television to Fox Sports. Internationally, TCI operated in England, Japan and Argentina. Along the way, Magness accumulated a billion-dollar fortune, part of which he spent on raising his prized Arabian horses and collecting western art.

Born in 1924, Magness served as an infantryman in World War II, graduated from Oklahoma State College and tripped into the cable business in 1948 after selling cottonseed in Texas. He liked to do deals on a handshake, didn't say much and didn't have to. He was a taciturn westerner who headed the only one of six major cable families not based on the East Coast.

There was Cox in Atlanta, Comcast in Philadelphia, Cablevision on Long Island, New York, and Continental in Boston. They were known collectively as the four Cs, all tough in their own ways. There was also Time Warner, Inc., based in Manhattan, a bruising conglomerate.

But the desperado of the bunch, the universally acknowledged badass of the cable business, was TCI in Denver. It was the most influential and the most feared because it was the most mercenary. TCI did a deal a week and treated its local cable monopolies like rickety cash machines, skimping on upkeep and piling on debt to buy even more systems.

"I'd have to think harder to quit doing acquisitions than I would to keep doing them," Magness once said, his folksy manner belying a voracious appetite for expansion.

Cable had grown up in places like Astoria, Oregon; Memphis, Texas; Mankato, Minnesota; and Mahanoy City, Pennsylvania. They were communities isolated from the national conversation that was television. Magness and other cable cowboys shimmied up poles and caught splinters hanging wire, collecting a few dollars each month from every customer they could hook up in 1950s rural America.

Cable began by carrying the signals of independent TV stations and the Big Three: ABC, CBS and NBC. The broadcasters intended

to dominate TV forever. But cable relied on the broadcasters to grow up, then blew past them. With cable-only networks like HBO, ESPN and MTV as a draw, 40 million new subscribers signed up in the 1980s, making cable almost as much of a household utility as phone, natural gas and electric service.

By 1990, TCI's revenues were more than the Big Three broadcasters combined.

From rural roots, the cable industry evolved into a loosely grouped gang with internal discord, but with even greater common foes: obstructionist broadcasters, the Hollywood studio syndicate, the heavyweight Baby Bells, an antagonistic press, a regulatory Congress, parochial town councils and stealthy cable pirates. The cable chiefs bought, sold and swapped systems like tribal lords. They carved up urban markets and grew rich from owning stock in monopolies built from the ground up. Ten men on the *Forbes* list of the 400 richest Americans made their money in cable and programming, though few of the names besides Ted Turner were well-known.

The cable gang had only one great fear: competition.

By the time of Magness's death, cable's boom years were long gone. The industry was spending billions of dollars to rebuild its aging coaxial networks into a pipeline to carry Internet and phone traffic a market the Baby Bell phone companies wanted for their own. Meanwhile, the cash flow funding the cable pipeline construction was under siege. The federal government had capped cable rates in 1992. Programming costs were rising.

From the sky came a killer: satellite TV. Companies like DirecTV and EchoStar offered nearly 200 channels of diamond-sharp TV pictures and sound, delivered by satellite to 18-inch dishes attached to homes. Cable subscribers angry at rate hikes and poor service had an alternative. Millions grabbed it. DirecTV became the fastest-selling consumer electronics product in history, faster than the VCR, the fax machine and the TV itself.

The cable gang was in a space-based pincer. DirecTV, backed by the deep pockets of General Motors' Hughes Electronics, targeted

cable's highest-revenue customers with exclusive sports and an array of pay-per-view movies. EchoStar trolled the low end by basically giving away satellite systems to capture monthly programming fees. Struggling to remain competitive was the cable gang's own satellite TV service named Primestar.

So, as Ted Turner and his cable brethren filed into church on that crisp November day in 1996, they grieved for one of their own, a godfather of the cable industry, Bob Magness. But they might well have mourned the death of another entity that had brought them power and riches beyond their wildest dreams: monopoly.

Deal-driven and debt-laden, TCI faced particular pressure from satellite TV's airborne assault. Even as it added more and more subscribers through acquisitions, TCI lost tens of thousands of basic subscribers and nearly one million premium subscriptions to lucrative pay channels like HBO in 1996. TCI's \$15 billion debt was six times its cash flow, a precarious leverage ratio. Investor and banker confidence in the company's management eroded. Its stock price slid to a sickly \$12.

Two weeks after the Magness funeral, just before Christmas, TCI would cut 2,500 of 38,500 jobs, slice executive salaries by 20 percent and put its four corporate jets up for sale. The Magness estate's big block of TCI stock was up for grabs, while takeover vultures, including Microsoft chief Bill Gates, circled overhead.

John Charles Custer Malone, the man who had the most to lose from this troubling convergence of events, sat in a front pew of the church, awaiting his turn to memorialize Magness his mentor, business partner and dose friend through three decades. Magness was TCI's founder and chairman, but the cable company's financing schemes and aloof corporate culture flowed from the mercurial Malone.

Malone was a problem solver, not a glad-hander. He could be gracious and charming, or cold and cutting, in the same tone of voice. He took the long view in his business and personal life. He had been TCI's chief for 23 years and married for 33 years to his hometown sweetheart, Leslie, with whom he had raised a son and a

daughter. He was an engineer in the purest sense of the word, a man at ease building things, whether it was a cable television empire or Legos on the floor of his office with a grandchild.

His handsome face was cut into sharp planes, with a straight nose and thin lips. His dark hair, going gray, was short and neatly parted on the right. His eyes were deep and watchful, like a shark measuring its prey. At 55, Malone had the wealth, position, power and perks commensurate with running a multibillion-dollar media conglomerate.

Malone shielded his private life, even as he dominated an industry whose purpose and profit are founded on exposure. Few people had ever been to his house or met his wife, an art collector and charity volunteer whose fear of flying dictated that Malone drive them across country to their vacation home in Boothbay, Maine. While expressing fealty to his wife, Malone was absolutely ferocious in his business life. Whether TCI subscribers were pleased with their cable service or not, whether TCI was seen as a good corporate citizen or not, had little to do with Malone's singular mission.

"TCI is purely and simply a wealth creator," he said many times. In this, he embodied the raw capitalist spirit described by Scottish economist Adam Smith in 1776, who wrote, "By directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. . . . By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it."

Thus was the conundrum behind Malone's piercing hazel eyes in the winter of 1996. Was he a deal-making visionary helping to build a communications railroad for the twenty-first century? Or a heartless monopolist constructing a debt-laden pyramid for the enrichment of himself and his cable cronies? Or both?

"I would call myself a corporate architect, a systems engineer," he once said. "I like to play the strategic games, a whole lot of moves into the future."

When things got bad, and they were about to get very bad in the months following Magness's death, Malone relied on his prized asset: his mainframe brain. With a doctorate in operations research, Dr. Malone as he was sometimes known often worked backward from the answer he desired to define the problem. This worked well with Turner and Rupert Murdoch, two gut-driven moguls in awe of Malone's calculating mind. This tactic was of less use with Gates, who shared Malone's hyper-rational worldview. As software and cable technologies converged in the promise of a new set-top box to give the dumb TV a computer brain, Gates and Malone acted at times like two scorpions trapped in a bottle of their own making, seeking an advantage that could only come at the other's expense.

In public, Malone was alternately imperious and shy, with a wicked sense of humor. He usually said what he thought, not what he felt. But on the occasion of his mentor's funeral, Malone revealed a deep filial bond.

"I've probably given 1,000 speeches in the past 30 years," Malone began, standing at the lectern, the flag-draped coffin between himself and his listeners. "This is the toughest one for me."

Magness had hired Malone when the younger man was president of Jerrold Electronics, a Pennsylvania company that supplied remote controls and cable equipment.

"When I finally got to Denver," Malone told the mourners, "I found that Bob had rearranged our offices so that we were back to back. He had his office. I had mine. There was a pathway in between. For 25 years, that's been the configuration wherever we've gone. I've always had Bob protecting my back."

Malone, the Yankee engineer, and Magness, the sharp-eyed cowboy, were an odd couple and inseparable. They rarely bickered and even stayed in the same hotel rooms on the road in the 1970s as they staved off financial ruin at TCI. Magness was the wise elder and Malone the muscle who would attempt to control the cable industry as John D. Rockefeller did the oil business a century before. At its height, Rockefeller's Standard Oil Trust controlled 90 percent

of the country's oil production, a lucrative clamp on both the pipeline and the oil that flowed through it, effectively fixing prices.

Malone would attempt a similar feat with the cable pipe and the programming that flowed through it. This was seen as arrogance by competitors, with disdain by critics and as cause for alarm by regulators. As with Rockefeller, the fear of Malone was born from his particular genius. This did not just mean very smart, which he was, or ruthless, which he could be. It meant that Malone knew more about the economics and technology of his chosen field and how to work these to his advantage than anyone else. Rockefeller did not start out the biggest, nor the richest, nor the smartest. He achieved great power by accepting without emotion how the world works and by bringing an analytical mind to bear on the underlying problem, which is where to apply leverage to achieve the maximum effect.

Leverage rules. That Malone could see forward and calculate backward helped him apply this lesson earlier, more consistently and more fruitfully, than his colleagues and rivals. Thus was his reputation built, his counsel valued, his favors sought and his retributions avoided.

Malone entered, then dominated, a business that was a modern-day gusher, with the gloss of entertainment, the economics of a utility and the promise of a monopoly. Malone owed much of it to Magness.

"I came to love Bob," he told the mourners. "A man of enormous virtues. Quiet, but deep, solid, loyal. Brilliant in many ways, self-effacing. We went through a lot of experiences together. We were partners, he was my mentor. In many ways, he was my father."

Malone addressed a congregation that had done many deals together, fought many battles and kept many secrets. Al Gore, as a rising U.S. senator from Tennessee, had described them as the "Cable Cosa Nostra, the family that controls the distribution," with Malone its unscrupulous head. Malone despised Gore's politics and grandstanding. Yet, Malone's oration at Magness's funeral echoed Gore's criticism and elicited some knowing chuckles.

"We were frequently unindicted co-conspirators," Malone said of himself and Magness. "We built a company. I joined a family."

A prominent member of the cable family, and the next to eulogize Magness, was Turner, the Atlanta media maverick and vice chairman of Time Warner Inc. Lithium treatments and marriage to Jane Fonda had somewhat tamed Turner, though there was no restraining "The Mouth of the South." There was also no denying his peculiar stamp on American culture. His Atlanta Superstation, CNN, the Cartoon Network and Turner Classic Movies supplied much of the video buzz that flowed through the lines of TCI, Time Warner and much smaller cable companies into tens of millions of TV sets worldwide.

In the late 1980s, however, Turner's company was on the brink after a high-priced deal to buy the MGM studio and film library. TCI and other members of the cable gang kept Turner afloat, while tying his hands so that any big-ticket purchase needed approval by a new board of directors, which included Malone.

"I've got him right where I want him," Malone reportedly said of Turner.

Turner was a little more earthy when he described Time Warner's restrictions on his ability to buy a broadcast network or some other media toy.

"I'm being clitorized," said Turner.

Still, Turner owed much of his success, and eventual Time Warner riches, to the intercession of Malone and Magness. It was fitting that he speak at Magness's funeral, though his comments were as much a self-tribute as a memorial. Such a ham was Turner that some of the mourners felt the corners of their mouths lift involuntarily, tickled by his deep-fried stream of consciousness, delivered in a croaking singsong.

"I hope there's this many people at my funeral," said Turner, who at one point blew his nose into a white handkerchief, then stared briefly at the result.

"I always used to say, 'You build the wires and we'll make 'em sing,'" Turner said of Magness and Malone. "And it really worked

out. Then we needed hundreds of millions of dollars and Bob and John came forward and became equity partners in the company." Turner credited Magness with not only saving his company but introducing him to the West, great swaths of which Turner subsequently bought in New Mexico and Montana, becoming one of the nation's largest individual landholders with one million acres.

"Those mountains that run all the way from Canada to, I don't know, Mexico," said Turner. "And I'm trying to buy as much of it as I can."

Turner said that Bob and Sharonreferring to Magness's second wife, who sat solemnly in a front pewhad come to visit him and Jane Fonda at their ranch in Montana, a state where Magness began building his cable empire in the 1950s. Turner and Magness stopped by a microwave transmission tower that Magness once serviced during a snowstorm.

"When we first met, I didn't have two nickels to rub together," said Turner. "Before it was over, we were talking about hundreds of millions, you know. So we really were about as successful as you could possibly be."

After the funeral service, pallbearers including Malone, Turner and Magness's two sons by his first marriage, Kim and Gary, carried the casket containing the fallen patriarch to a waiting hearse. The mourners poured out of the church, having paid their respects to a man whose company, for better and worse, defined the U.S. cable industry.

One executive recalled a baseball playoff game in Denver the year before between the Colorado Rockies and Turner's Atlanta Braves. TV commentators spotted Turner and Malone in a lower-level box and wondered aloud "who the man sitting next to them is." It was Magness, of course, whose low profile hid much wheeling and dealing. His greatest coup was hiring Malone, whom Magness once described as "the smartest son-of-a-bitch I have ever met."

Few in the cable gang, particularly those at the funeral, would disagree. All of them had ties to TCI and most of them owed Malone and Magness some debt of loyalty. There was Glenn Jones, a

Colorado cable lawyer who bought his first cable system by borrowing \$400 against his Volkswagen in 1968. He went on to build one of the nation's top ten cable companies and launched an educational channel that initially relied on TCI for distribution.

There was Ralph and Brian Roberts, the father-and-son team who headed Comcast, based in Philadelphia. TCI and Comcast had several profitable investments in common, yet there was a rivalry between Brian Roberts and Malone.

There was Daniel Ritchie, the chancellor of the University of Denver and a former chief of Westinghouse Broadcasting. A longtime Magness family friend, Ritchie was a co-executor of the Magness estate, which left \$10 million to the university.

And there was Tim Robertson, son of televangelist Pat Robertson. In 1990, TCI helped the Robertsons finance a lucrative separation of their Family Channel from the company's religious ministry based in Virginia Beach, Virginia.

Out of loyalty and self-interest, it was unheard of for these men or any others within the cable industry to criticize TCI publicly, even though the company's arrogance had given the industry a black eye and helped lead to kneecapping rate regulation by the federal government in 1992. Within the cable gang, testosterone, shared experience, blood oaths and distrust of outsiders ruled the day.

Malone was the kingpin.

He suspected, but could not foresee, the turmoil that was about to engulf TCI and the cable industry, events that would send its prospects plunging and call into question his own vaunted ability to sell the electronic frontier to Wall Street, investors and the media.

One of Malone's duties, as TCI grew influential domestically and overseas, was to negotiate with Murdoch, carving up the world in their minds if not in reality. They attended to their mutual business interests like heads of state. Murdoch's News Corp. was the supplier of popular Fox networks to TCI and the cable industry. The two men were partners in billion-dollar programming ventures in the United States and satellite TV service in Latin America. In England,

however, they competed head-on. Murdoch's satellite TV service, British Sky Broadcasting, dominated. It served five million households and controlled key sports and movie rights. TeleWest, a company part-owned by TCI, was BSkyB's landline competitor, offering cable and phone service.

Murdoch and Malone played an endless, international game of cutthroat, partnering here, competing there and always playing on the edge. In early 1997, as Malone and the cable gang had their backs against a wall, Murdoch took aim. He had long wanted to control satellite distribution in the lucrative U.S. market, as he did in England. To advance his plan, Murdoch picked a partner right in Malone's backyard, a renegade named Charlie Ergen, who intended to put a satellite dish on every home and put John Malone and the cable gang out of business.

Two Deathstar

Introduced by horn-heavy instrumental jazz, Rupert Murdoch strode to a podium on a soundstage at the Fox movie lot in Hollywood on February 24, 1997. To his left was a large blue video map of the world. The name of Murdoch's global media empire, News Corp., was spelled out vertically on each of the four pillars on stage.

Wearing a dark, double-breasted suit, the tycoon saluted with his left hand, shielding his eyeglasses from the glare of red, blue and green spotlights that beamed down. He gained a better look at his audience: row upon row of industry analysts sitting at long, white-draped tables. The analysts, from firms such as Smith Barney and Goldman Sachs, had heard the expected reports that day on News Corp.'s financial health. They were told to stay late that afternoon for a special announcement, described by Murdoch as "our most ambitious project of all."

The pirate was about to swing his sword at the cable gang.

Reading verbatim from a press release, and thereby referring to himself in the third person, Murdoch announced that News Corp.'s American Sky Broadcasting would merge with EchoStar Communications Corp. in a \$1.7 billion deal. Murdoch's Aussie accent elongated the *e* and softened the *r* of EchoStar to "Eeekostah."

The new alliance would simply be named Sky, matching several Murdoch satellite services around the world in an attempt to make the brand as well-known as Coca-Cola.