

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In re Application of)	
)	
ECHOSTAR COMMUNICATIONS CORPORATION,)	
GENERAL MOTORS CORPORATION,)	
HUGHES ELECTRONICS CORPORATION,)	
)	
Transferors,)	CS DOCKET NO. 01-348
and)	
)	
ECHOSTAR COMMUNICATIONS CORPORATION,)	
)	
Transferee,)	
)	
For Authority to Transfer Control.)	
)	

To: The Commission

EX PARTE REPLY TO OPPOSITION

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SUMMARY

EchoStar and DIRECTV have proposed a merger with demonstrated anticompetitive effects in local markets across the United States. Their defense of the merger is to rely on unenforceable promises and ephemeral benefits. The Applicants have twice had the opportunity to justify their merger and they have twice failed to do so, despite the fact that the burden is on them to do so.

It is undisputed that this is a merger to monopoly in many local markets and for millions of consumers. By DIRECTV's own account, 29 percent of its subscribers (over 3 million households) do not have access to cable. When one adds to that number the EchoStar subscribers who do not have access to cable, the inhabitants of non-cabled areas who do not subscribe to DBS today, and the 15 million households in areas served by weak, analog cable systems that are likely to go extinct because they cannot justify the expense to upgrade to digital, it is clear that a significant segment of the population will be subject to a multichannel video programming distribution monopoly if this merger is approved.

In nearly all other markets, this will be a merger to duopoly, and will eliminate the vigorous head-to-head rivalry between the two DBS companies. EchoStar, of course, consistently insisted that DBS was a separate market until this merger was proposed, including in its antitrust litigation against DIRECTV in which it alleged the two competed in a "High-Power DBS Market." The fact that the two DBS companies' prices track one another but not cable, as Appendix A shows, is further evidence of the intensive rivalry between EchoStar and DIRECTV.

Mergers to monopoly or duopoly such as the one proposed here, are routinely condemned by antitrust authorities. The Applicants do not even attempt to counter the voluminous precedent condemning such mergers. They are also silent as to the rocketing growth and robust health of

the DBS industry. Both EchoStar and DIRECTV showed record results in 2001 and the first quarter of 2002 – although they absurdly depict themselves as teetering near oblivion in their Opposition.

Against the uncontroverted evidence of competitive harm, the Applicants fail to demonstrate the “extraordinary efficiencies” necessary to justify such an anticompetitive acquisition. The main efficiency promised is their recent “miraculous” discovery that they can carry all local broadcast stations in all 210 Designated Market Areas. But EchoStar took back that promise almost as soon as it was made, filing a Supreme Court petition explicitly stating that it “does not intend to carry all channels in every market unless the decision below is upheld.”¹ EchoStar also resists any merger condition that would eliminate its “two-dish” reception scheme, and has set no deadline for when its 210 market promise would be fulfilled (although any such deadline would be unenforceable anyway).

In any event, carriage of local stations in all 210 DMAs is not a merger-specific efficiency because each party could deliver all local stations on its own or the Applicants could do so together through a production joint venture. The NAB and its broadcaster members prefer to rely on the present competitive rivalry between the two DBS companies and the substantial benefits that accrue to the DBS companies when they carry local stations (more subscribers, less churn, and extra revenues from subscribers for local stations) to achieve local-to-local carriage, rather

¹ *Satellite Broadcasting and Communications Ass’n et al., Petition for Writ of Certiorari, Satellite Broadcasting and Communications Ass’n v. FCC*, 70 U.S.L.W. 3580, at 8 n.2 (U.S. Mar. 7, 2002) (No. 01-1332) (emphasis added).

than the promises of a company that the Commission has chastised for “its ‘disingenuous’ behavior and lack of candor.”²

The other purported efficiencies listed by the Applicants consist principally of additional programming and various enhanced services and certain cost savings. However, the Applicants fail to quantify these alleged efficiencies in any meaningful way. Such vague, unverifiable efficiency claims are far too speculative to be given any weight, particularly when placed against the known competitive harms that occur with mergers to monopoly or duopoly.

The Applicants’ proposed solution to the obvious anticompetitive effect of a merger to monopoly is a national pricing plan. But the Applicants are not actually proposing uniform national pricing, as Mr. Ergen himself admits when he reserves to himself the ability to respond to specific offers in a particular location. (Indeed, the Applicants have to ignore the critically important elements of equipment and installation even to pretend that they would offer national pricing.) In addition, there are any number of ways that New EchoStar could discriminate between rural (monopoly) and urban (duopoly) customers.

Further, a national price would be above the competitive level for two reasons. First, with only one DBS company and one cable company in most urban areas, the urban price itself would be a supracompetitive duopoly price. Second, a single national price would be set somewhere between the urban duopoly price and the higher rural monopoly price.

If the Commission accepts EchoStar’s proposal it will find itself entwined in old-fashioned utility rate regulation—exactly the regime the Telecommunications Act of 1996 intended to replace with one based on competition.

² *In re National Association of Broadcasters and Association of Local Television Stations*, DA 02-765, CSR-5865-Z, at 19 n.116 (Media Bureau Apr. 4, 2002).

The Applicants have failed to carry their burden of demonstrating that the proposed merger would serve competition in the public interest. Therefore, the Application should be denied.

Table of Contents

I.	INTRODUCTION.....	1
II.	THE APPLICANTS FAIL TO REBUT THE EVIDENCE OF ANTICOMPETITIVE EFFECTS RESULTING FROM THE ACQUISITION	4
A.	This Is a Merger to Monopoly in Many Markets.	4
B.	This Is at Best a Merger to Duopoly in All Other Markets.....	8
C.	The Applicants Do Not Even Attempt to Refute the Overwhelming Legal Precedent Against Mergers to Monopoly or Duopoly.	12
D.	The DBS Companies Are Thriving Absent Merger.....	14
III.	THE APPLICANTS’ CLAIMS OF EFFICIENCIES ARE HOLLOW AND UNSUBSTANTIATED.	15
A.	The Promise of Local to Local in 210 Markets is Unreliable.	16
B.	Less Anticompetitive Alternatives Are Available to Achieve Local-to- Local Service in All 210 Markets.	19
C.	Other Purported Efficiencies Are Advanced Casually with No Attempt at Rigor.	22
IV.	THE APPLICANTS FAIL TO SHOW THAT A NATIONAL PRICING PLAN IS EITHER WORKABLE OR DESIRABLE.	25
A.	Discrimination Is Feasible.	26
B.	EchoStar Acknowledges That National Pricing Is Unworkable and Insists on Exceptions.....	27
C.	A National Price Would Be Above the Competitive Level.	29
D.	A Uniform National Price Would Make Coordinated Behavior Easier.....	29

V. CONCLUSION30

APPENDIX A: Cable v. DBS-Indexes of Monthly Prices Over Time

APPENDIX B: Supplemental Declaration of Richard G. Gould

APPENDIX C: Reply Declaration of J. Gregory Sidak

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EX PARTE
REPLY TO OPPOSITION

I. INTRODUCTION

The National Association of Broadcasters (“NAB”) respectfully submits this Reply to highlight several important deficiencies in the Opposition to Petition to Deny and Reply Comments filed by the Applicants in this matter.³ While the proposed merger threatens real

³ Opposition to Petitions to Deny and Reply Comments of General Motors Corporation and Hughes Electronics Corporation and EchoStar Communications Corporation, CS Docket No. 01-348 (filed Feb. 25, 2002) (“Opposition”).

competitive harms, EchoStar and DIRECTV instead rely on hollow promises. In doing so, the Applicants fail utterly to carry their burden of demonstrating that the merger would serve the public interest.

Both the public interest standard and relevant merger law require the parties to detail with specificity why they believe the anticompetitive effects of the merger are overcome by procompetitive factors. That specificity is completely lacking from either the Application or the Applicants' Opposition.

Most tellingly, the Opposition fails to grapple with the central point of the numerous petitions to deny filed on February 4, 2002: the merger of EchoStar and DIRECTV will create a monopoly in many local markets and a duopoly in nearly all other local markets. The result will be higher prices for urban and rural consumers. In addition, local broadcasters, the primary source of local programming, will be subject to the market power of an unregulated gatekeeper.

Instead of attempting to refute the clear evidence of anticompetitive effects, the Applicants claim the merger is justified by alleged efficiencies. The chief claimed efficiency is a "promise" to offer local-to-local service in all 210 television markets. But this "promise" is really no promise. As the publisher of a leading satellite industry trade publication described it, the announcement is "a very shrewd political Hail Mary with no downside because it's unenforceable."⁴ In fact, EchoStar, unsurprisingly, immediately backtracked on this promise. Within days of making this commitment to both the Commission and Congress, EchoStar filed a Petition for a Writ of Certiorari at the Supreme Court, stating that if it wins its "must carry" case,

⁴ David Lieberman, *EchoStar promises more local TV after merger*, USA TODAY, Feb. 27, 2002 (quoting Bob Scherman, Publisher of Satellite Business News) <<http://www.usatoday.com/life/cyber/tech/2002/02/26/echo-star-directv.htm>> (visited Apr. 18, 2002).

“the merged entity does not intend to carry all channels in every market. . . .”⁵ The other efficiencies claimed by the Applicants are vague, general and unquantified. As such, they cannot justify what would otherwise be an anticompetitive merger.

The Applicants attempt to overcome the inconvenient fact that this is a merger to monopoly in many local markets, for many millions of consumers,⁶ by their “pledge” of a national pricing plan. This “pledge” is as ephemeral as EchoStar’s “promise” to carry all local television stations. When one reads the fine print, it becomes clear that EchoStar interprets its pledge to allow responses to local competitive situations, and that the pledge encompasses only some elements of the total DBS price. The simple truth is that a national pricing plan is unworkable. If it did work, it would still mean a uniform price above the competitive level. Further, a uniform price would stifle local competition and enmesh this Commission in an unwieldy regulatory tangle that is the antithesis of the deregulatory mandate Congress gave the Commission in the Telecommunications Act of 1996.

⁵ *Satellite Broadcasting and Communications Ass’n et al.*, Petition for Writ of Certiorari, *Satellite Broadcasting and Communications Ass’n v. FCC*, 70 U.S.L.W. 3580 (U.S. Mar. 7, 2002) (No. 01-1332).

⁶ By DIRECTV’s own account, based on surveys of its own customers, nearly 30 percent of its customers do not even have access to cable. As discussed below, the Applicants make no effort to refute – indeed, fail even to mention – this devastating admission.

II. THE APPLICANTS FAIL TO REBUT THE EVIDENCE OF ANTICOMPETITIVE EFFECTS RESULTING FROM THE ACQUISITION

In this license transfer proceeding, the burden is on the proponents of the merger to show that it is in the public interest.⁷ Similarly, under the Clayton Act, a merger that creates a highly concentrated market, as here, is presumed to lessen competition and the burden shifts to the proponents to demonstrate that the effect of the merger will not be anticompetitive.⁸ The Applicants here fail to carry their burden of demonstrating that the merger, which would further concentrate already highly concentrated local multichannel video programming distribution (“MVPD”) markets, will not lessen competition. In instance after instance, where the legal standard requires a showing with specificity, the Applicants provide generalities or promises that prove to be illusory upon examination.

A. This Is a Merger to Monopoly in Many Markets.

The parties have not challenged – nor can they – the fact that for many millions of predominantly rural consumers DBS will become the only MVPD. Dr. Willig’s initial declaration glossed over this fact by claiming that the relevant geographic market was national

⁷ See *In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations by Time Warner Inc. and America Online, Inc., Transferors, to AOL Time Warner Inc., Transferee*, CS Docket No. 00-30, Memorandum Opinion and Order, 16 F.C.C.R. 6547, 6554 ¶4 (2001) (“The Applicants bear the burden of proving that the transfer will advance the public interest.”).

⁸ See United States Dep’t of Justice & Federal Trade Comm’n, *Horizontal Merger Guidelines*; *FTC v. H. J. Heinz Co.*, 246 F.3d 708 (D.C. Cir. 2001).

because the DBS firms charged a national price.⁹ Yet in his reply declaration, Dr. Willig stated that Pegasus, a DIRECTV retailer for rural areas, charges an additional \$3 above DIRECTV's own monthly subscriber fees.¹⁰ Furthermore, in another FCC proceeding Dr. Willig recently argued that the broadband Internet market should be evaluated at the local level.¹¹ As the Sidak Reply Declaration points out, the appropriate geographic markets clearly are local.¹²

The parties attempt to minimize the number of households not passed by cable to detract from the competitive impact of the many local MVPD monopolies, relying on data supplied to the Commission by the cable industry.¹³ But that data cannot possibly be accurate, as the National Rural Telecommunications Cooperative ("NRTC") demonstrated.¹⁴ NRTC also refuted effectively the Applicants' attempt to challenge its analysis.¹⁵ Much more likely to be accurate is

⁹ Declaration of Robert D. Willig on Behalf of EchoStar Communications Corporation, General Motors Corporation, and Hughes Electronics Corporation, ¶ 93 (Nov. 30, 2001) ("Willig Declaration").

¹⁰ Reply Declaration of Robert D. Willig on Behalf of EchoStar Communications Corporation, General Motors Corporation, and Hughes Electronics Corporation, ¶ 93 (Feb. 25, 2002) ("Willig Reply Declaration").

¹¹ Declaration of Robert D. Willig on Behalf of AT&T Corp., in Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services, CC Docket No. 01-337 at 20, ¶ 35 (Feb. 28, 2002).

¹² Reply Declaration of J. Gregory Sidak, ¶¶ 18-19 ("Sidak Reply Declaration") (Attached as Appendix C).

¹³ Opposition at 59-66.

¹⁴ Petition to Deny of National Rural Telecommunications Cooperative, CS Docket 01-348 (filed Feb. 4, 2002).

¹⁵ Ex Parte Reply to Opposition of National Rural Telecommunications Cooperative (filed Apr. 4, 2002). The Applicants attack the Warren Communications data which is the source of the 81 percent estimate, claiming to have located twenty zip codes that Warren lists as not passed by cable that are in fact passed by cable. Willig Reply Declaration at 63-66. But, Dr. Willig's analysis fails to consider that the Warren data presents census blocks which are wired for cable, not zip codes. See Reply Declaration of Paul W. MacAvoy on behalf of the National Rural

the study by the National Telecommunications and Information Administration and Rural Utilities Services which calculates that the number of homes passed by cable may be as low as 81 percent.¹⁶

But most significantly, neither the Applicants nor Dr. Willig cite or deal with DIRECTV's own internal data showing that 29 percent of its subscribers (over 3 million) have no access to cable.¹⁷ Assuming the same percentage for EchoStar (which in all likelihood actually tilts more rural than DIRECTV) would mean that over 5 million DBS subscribers have no cable access today. These predominantly rural DBS subscribers (as well as an unknown number of their neighbors who also lack cable access but do not currently subscribe to DBS) would be subject to an MVPD monopoly if this merger is approved. The DIRECTV claim is consistent with a New York Times report that in as many as 22 states over 30 percent of homes lack cable access.¹⁸

Telecommunications Cooperative, ¶¶10-11 (Apr. 2, 2002) (“MacAvoy Reply Declaration”); Sidak Reply Declaration at ¶¶ 41-43. Zip codes are much larger than census blocks, so the fact that one person in a zip code territory has cable service does not mean everyone in every census block within that zip code has cable access. There are 8 million census blocks but only 42,193 zip codes. Nor does Dr. Willig provide data showing how many zip codes his research firm reviewed to come up with the 20 zip codes allegedly miscalculated by Warren as not passed by cable. Obviously, an error rate of .1 percent versus 10 percent would affect the reliability of the data. The failure to provide complete data from the study should cause the Commission to disregard it.

¹⁶ National Telecommunications and Information Administration, United States Department of Commerce and Rural Utilities Service, United States Department of Agriculture, *Advanced Telecommunications in Rural America: The Challenge of Bringing Broadband Service to All Americans*, at 19 & n.62 (Apr. 2000).

¹⁷ See Comments of DIRECTV, Inc., In the Matter of Annual Assessment of the Status of Competition in the Markets for the Delivery of Video Programming, CS Docket No. 01-129, at 13 (filed Aug. 3, 2001) (only “71% of DIRECTV customers live in areas able to receive television service.”).

¹⁸ See *Look, Up in the Sky! Big Bets on a Big Deal*, N.Y. TIMES, Oct. 30, 2001, at C-1.

As EchoStar once said:

“Millions of potential DBS and/or High Power DBS customers live in areas that do not have access to cable such that, if there is no competition between DIRECTV and EchoStar, there is no competition at all.”¹⁹

Further, the actual number of consumers who ultimately will be subject to a monopoly is much higher. The NAB’s Petition to Deny cited an exhaustive CS First Boston study of every cable system in the United States that gauged the likelihood that each system could financially justify upgrading its facilities for digital cable/cable modem services.²⁰ The analysis found that 8,270 cable systems serving 8.2 million subscribers “could become extinct over the next five to eight years,” with the vast majority of their subscribers becoming DBS customers.²¹ CS First Boston estimated that this could add \$15 – 37 billion of shareholder value to a DBS industry currently valued at \$26-27 billion.²²

It should also be considered that the 8.2 million represents only those households in areas served by weaker cable systems that subscribe to cable. Rural cable penetration is about 54 percent,²³ which means that approximately 15 million households are in the areas served by cable systems that are likely to go out of business in the next five to eight years, leaving all of these

¹⁹ Memorandum of Law in Support of Request for Rule 56(f) Continuance to Respond to DIRECTV Defendants’ Motion for Summary Judgment, *EchoStar Communications Corp. v. DIRECTV Enterprises, Inc.*, Civ. No. 00-K-212, at 12 (D. Colo. Nov. 6, 2000) (“EchoStar Memorandum”).

²⁰ Petition to Deny of National Association of Broadcasters, at 48-49.

²¹ Credit Suisse First Boston Equity Research, Natural Selection: *DBS Should Thrive as the Fittest to Serve Rural America*, at 3 (Oct. 12, 2001).

²² *Id.*

²³ *Id.* at 4.

households subject to a monopoly DBS provider (as well as the more than five million DBS subscribers and unknown number of other households who already have no access to cable).

In response to this detailed and logically convincing evidence of the likely demise of these rural cable systems, the Applicants, as is their practice throughout, provide no hard data, limiting themselves to a few cursory citations to promotional statements of cable trade associations.²⁴ Their fallback argument is that even if a smaller operator went bankrupt, the plant would be purchased by a successor who could run it more efficiently.²⁵ But the economic unattractiveness of low-density cable systems is not likely to change simply because the plant is owned by a larger entity: DBS firms will continue to be able to offer better services at a lower price because the geographic spread of households is immaterial to them. And even if these weak rural systems are purchased by larger MSOs, they will, with limited exceptions, be unable to justify economically making the investment necessary to offer digital cable/cable modem service. Who owns the system is largely irrelevant to such a decision.

B. This Is at Best a Merger to Duopoly in All Other Markets.

The NAB has presented voluminous evidence that EchoStar and DIRECTV are vigorous head-to-head rivals, and are certainly next best substitutes.²⁶ In response to the detailed descriptions of the EchoStar-DIRECTV rivalry put forth by the merger's opponents, the parties claim that "most of it is flawed and misleading," but then attempt to refute only a handful of the

²⁴ Opposition at 78-79.

²⁵ *Id.* at 79.

²⁶ NAB Petition to Deny at 15-32.

nearly two score examples cited, while ignoring their own past statements that they compete intensely.

For example, in announcing a planned price cut in 1997, EchoStar said that it "fully expect[ed] that, once again, this price point *will force the rest of the DBS industry* to reevaluate their current offers in response to EchoStar's lead."²⁷ The same pattern -- of one DBS firm responding quickly to, and often matching, the other's pricing -- continues today. For example, in December 2001, the two firms announced that they would charge precisely the same amount (\$5.99) for local-to-local packages -- even though DirecTV could easily have justified charging much more than EchoStar (since it offers all local stations on one dish rather than forcing consumers in many markets to acquire a second dish), and even though a "cable-matching" price would likely have been much higher (since cable firms charge much more for "broadcast basic" packages).

Consistent with this bitter head-to-head rivalry, EchoStar had proclaimed that "EchoStar is DIRECTV's closest competitor" and that "DIRECTV and EchoStar react primarily to each other when setting equipment and service prices."²⁸ EchoStar now attempts to minimize these statements and its consistent opinion (until now) that DBS is a separate market by disingenuously belittling its November 2000 Rule 56(f) motion to the district court in its litigation against DIRECTV -- in which it repeatedly stated that "DBS is a separate product market" from an MVPD market -- as a mere "pre-trial request for extension of time in a now dismissed antitrust dispute"²⁹ that "did not purport to be statements of proven fact."³⁰ The parties now claim that

²⁷ See NAB Petition at 17 (quoting EchoStar press release) (emphasis added).

²⁸ EchoStar Memorandum at 12.

²⁹ Opposition at 56.

“EchoStar has always held the same view: that there is one MVPD market,” citing a series of dated submissions to the Commission from 1996 to 1998, as well as testimony from Mr. Ergen to Congress in 1999.³¹

However, the Applicants choose to ignore the fact that the Rule 56(f) motion was followed up in April 2001 by an Amended Complaint in which EchoStar alleged that the two companies compete in a “High-Power DBS Market.”³² Presumably, EchoStar filed its Amended Complaint in good faith. More recently, Mr. Ergen explained in a December 2001 interview that the parties “believe that there was a submarket of satellite, and still believe, that *there is a submarket of satellite, particularly in rural [areas].*”³³

The Applicants also ignore the fact that DBS prices track one another (but not cable), strongly suggesting that the two firms constrain each other’s pricing. See Appendix A. While cable rates have risen significantly in recent years, at a pace ahead of inflation, DBS program prices have remained relatively flat, increasing only twice since 1996.³⁴ As former FTC Chairman Robert Pitofsky testified to Congress recently, cable operators continually raise their

³⁰ *Id.* at 57.

³¹ *Id.* at 56-58.

³² Amended Complaint, *EchoStar Communications Corp. v. DIRECTV Enterprises, Inc.*, Civ. No. 00-K-212, ¶ 76, at 24 (D. Colo. Apr. 5, 2001).

³³ *Ergen Makes His Case*, SATELLITE BUS. NEWS, Dec. 31, 2001, at 11 (emphasis added).

³⁴ *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, FCC 01-389, CS Docket No. 01-129, Eighth Annual Report at 5 ¶ 9 (Jan. 14, 2002) (over the year reviewed, cable prices rose 4.24 percent versus 3.25 rate of inflation); Ergen House Testimony at 5 (“cable companies ... rais[ed] their prices an average of 6% per year over the last 10 years, more than twice the rate of inflation [while] satellite TV has maintained low monthly rates for service with minimal rate increases and even then, well below the rate of inflation.”).

rates while DBS prices remain stable because “the two satellite competitors keep prices down.”³⁵ This view is supported by the parties’ own statement that the merger will reduce “churn,” i.e., customers will have no ability to switch from one DBS company to the other because their customer bases will be consolidated.³⁶

Whether DBS is a separate product market, as EchoStar argued until recently, or a differentiated sector within an overall MVPD market, is not significant. What is significant is that this merger clearly would eliminate DIRECTV as the next best substitute for EchoStar and create a duopoly (and in many cases monopoly) in the already highly concentrated MVPD market.³⁷ The Applicants’ claims that they do not compete closely are mere rhetoric (and new-

³⁵ Jeffrey Bartash, *EchoStar, Hughes face Senate qualms*, CBS Marketwatch.com website (Mar. 6, 2002) (noting that “cable prices have risen about 7 percent every year since 1996, while annual satellite rates have climbed a scant 1 percent”)

<<http://cbs.marketwatch.com/tools/quotes/news.asp?symb=dish&sid=14836&siteid=mktw>> (visited Apr. 18, 2002).

³⁶ EchoStar Communications Corporation, General Motors Corporation, Hughes Electronics Corporation and EchoStar Communications Corporation Consolidated Application, at 36.

³⁷ Other MVPD providers and potential entrants have a trivial impact on the MVPD landscape. Despite the parties’ claim that other MVPD providers “retain significant subscribership” (Opp. at 48), MMDS and other small MVPD providers have proven failed entrants. The latest Commission competition report estimates their total collective share at less than 3.7 percent. *See* Eighth Annual Report at 6-7. Further, the number of entrants is shrinking, as overbuilders falter. *See* Linda Haugsted, *WINfirst the Latest Struggling Overbuilder*, Multichannel News (Mar. 18, 2002) (“WINfirst’s [bankruptcy] filing shrinks the number of overbuilders still moving ahead.”); Linda Haugstead, *Capital Constraints Cripple WINfirst, Too*, Multichannel News (Mar. 11, 2002) (“The inability to continue to raise large sums for telecom-network buildouts has killed or crippled many once-hot start-up ‘broadband service providers’ over the last couple of years.”).

In addition, the parties speculate that entry by DBS competitors may come from the use of orbital slots granted by the International Telecommunication Union to Mexico, Argentina and Canada. Opposition at 49. The DOJ/FTC Merger Guidelines require potential entry to be “timely, likely, and sufficient” to deter competitive efforts of concern. *See* Merger Guidelines § 3.2 (“The Agency generally will consider timely only those committed entry alternatives that can be achieved within two years from initial planning to significant market impact”). The

found rhetoric at that) that fly in the face of both common sense and the actual and extensive data supplied by the NAB and others.

C. The Applicants Do Not Even Attempt to Refute the Overwhelming Legal Precedent Against Mergers to Monopoly or Duopoly.

No public interest benefits are likely to arise from merger to monopoly or duopoly. It is no coincidence that mergers to monopoly are never approved by the courts or the agencies. Not surprisingly, the parties fail to cite a single instance where this has occurred. Mergers to duopoly are also routinely condemned. The parties fail even to mention, much less distinguish, the recent and leading precedent here: *FTC v. H.J. Heinz Co.*, 246 F.3d 708 (D.C. Cir. 2001). Instead, the parties practice the ostrich approach; they fail to discuss relevant case law at all, presumably in the hope that the Commission will not notice. Thus, they ignore what FTC Commissioner Thomas Leary recently described as the “broad consensus in the economics community that 2-1 and 3-2 combinations are likely to be particularly troublesome”.³⁸

The reason for this consensus is that the high degree of market concentration that is the inevitable byproduct of a merger to monopoly or duopoly is likely to give the surviving market participant(s) the unilateral ability to raise prices and to increase the likelihood of coordinated

Commission should use the same level of scrutiny, under which the foreign DBS slots fail any reasonable standard of likely entry within two years.

³⁸ Commissioner Thomas B. Leary, Three Hard Cases and Controversies: The FTC Looks at Baby Foods, Colas and Cakes, Prepared Remarks before The Association of the Bar of the City of New York’s Milton Handler Annual Antitrust Review (Dec. 4, 2001). See *FTC v. Swedish Match, Inc.*, 131 F. Supp. 2d 151 (D.D.C. 2000); *United States v. Franklin Elec. Co.*, 130 F. Supp. 2d 1025 (W.D. Wis. 2000); *FTC v. Staples, Inc.*, 970 F. Supp. 1066 (D.D.C. 1997); *United States v. United Tote, Inc.*, 768 F. Supp. 1064 (D. Del. 1991); *United States v. Ivaco, Inc.*, 704 F. Supp. 1409 (W.D. Mich. 1989).

interaction.³⁹ Thus, where a “merger further consolidates an already highly concentrated market . . . the Government establishes a rebuttable presumption that the merger is illegal under Section 7.”⁴⁰ Here, virtually all MVPD markets are already highly concentrated and the merger would increase the Herfindahl-Hirschman Index in the overwhelming majority of these markets by an amount that under the Merger Guidelines creates a presumption that a merger is “likely to create or enhance market power or facilitate its exercise.”⁴¹

The Sidak Declaration filed with the NAB’s Petition to Deny demonstrated how “troublesome” this merger to monopoly and/or duopoly would be: it would cause a consumer welfare loss of approximately \$3 billion over five years.⁴² Professor MacAvoy projected a similar level of consumer welfare loss.⁴³ While Dr. Willig criticizes the Sidak and MacAvoy estimates, he fails to support his own broad assertions that the merger will not cause consumer harm. Notably, Dr. Willig does not provide any analysis of elasticities, marginal cost reductions or efficiencies.

To refute the Sidak and MacAvoy estimates of consumer welfare loss, Dr. Willig would have to analyze subscriber and pricing data of the two DBS providers and then make projections of post-merger prices and quantities of the single surviving DBS provider.⁴⁴ The required data is within the control of the DBS companies. Yet the Applicants and Dr. Willig have failed to

³⁹ Merger Guidelines, § 2.

⁴⁰ *United Tote*, 768 F. Supp. at 1068.

⁴¹ Merger Guidelines, § 1.51(c).

⁴² Sidak Declaration at ¶ 51.

⁴³ MacAvoy Declaration at ¶ 38.

⁴⁴ MacAvoy Reply Declaration at ¶2.

provide any meaningful analysis of such data in either their Application or their Opposition. Instead, Dr. Willig relies on a small survey of new DIRECTV subscribers and two sets of churn data, which are uninformative, as Mr. Sidak demonstrates.⁴⁵ Thus, once again, the Applicants have failed to carry their burden of demonstrating that the merger will not have an anticompetitive effect.

D. The DBS Companies Are Thriving Absent Merger

EchoStar complains that it operates “with distinct disadvantages, against cable” and that “certain factors have historically inhibited DBS from robustly competing with cable.”⁴⁶ The Applicants cite a “profound risk” that “its customers [will] abandon the DBS platform” absent the merger.⁴⁷ They use this picture of a dire future to justify what would otherwise be an anticompetitive merger.

But, as is their pattern, these statements are not backed up with facts, and the publicly available facts are directly opposite to their assertions. Both EchoStar and DIRECTV are prospering as never before, thanks largely to their ability to offer local channels. According to recently released subscriber numbers, EchoStar added 400,000 net subscribers in the last fiscal quarter and passed the 7 million subscriber mark in February 2002, up from 5.26 million subscribers at the beginning of 2001 (a growth rate of 33 percent in fourteen months).⁴⁸

⁴⁵ Sidak Reply Declaration at ¶¶ 11-17.

⁴⁶ Opposition at 56.

⁴⁷ *Id.* at 12.

⁴⁸ EchoStar Press Release, “EchoStar Reports Record Fourth Quarter Revenue, EBITDA; EchoStar’s DISH Network Satellite TV Service Reaches 7 Million Customer Milestone” (Feb. 28, 2002) <http://www.corporate-ir.net/ireye/ir_site.zhtml?ticker=dish&script=410&layout=-6&item_id=263854 (visited Apr. 18, 2002); EchoStar Press Release, “EchoStar Reports Record Results for Fourth Quarter 2000; DISH Network Captures 55 Percent of Net New Direct

Meanwhile, DIRECTV reported 10.7 million subscribers at the end of 2001, a 13 percent increase over the 9.5 million subscribers at the end of 2000.⁴⁹ It also recently reported a net gain of 342,000 subscribers in the first quarter of 2002, substantially above expectations, and an 11% revenue growth rate over 2001.⁵⁰ This situation is similar to that in United Tote, where the merging parties “saw their market share increase year after year” and the Court found “unsupported in the facts and in the cases” the defendant’s claim that “it will be financially and strategically unable to keep up with the technological changes . . .”⁵¹

III. THE APPLICANTS’ CLAIMS OF EFFICIENCIES ARE HOLLOW AND UNSUBSTANTIATED.

As the Merger Guidelines explain, and the *Heinz* decision confirms, efficiencies virtually never justify a merger to monopoly or duopoly.⁵² The Applicants fail to carry their burden of showing that this is that rare case. Their proffered “efficiencies” are supported by no real analysis and in most instances consist of the vaguest generalities.

Broadcast Satellite TV Customers in 2000” (Mar. 21, 2001) <http://www.corporate-ir.net/ireve/ir_site.zhtml?ticker=dish&script=460&layout=-6&item_id=158165> (visited Apr. 18, 2002).

⁴⁹ Hughes Electronic Corporation Press Release, “HUGHES REPORTS FOURTH QUARTER 2001 FINANCIAL RESULTS: Strong DIRECTV U.S. Subscriber Growth Beats Expectations” (Jan. 15, 2002) <http://www.hughes.com/ir/pr/02_04_15_earnings.xml> (visited Apr. 18, 2002).

⁵⁰ Hughes Electronic Corporation Press Release, “HUGHES REPORTS FIRST QUARTER 2002 FINANCIAL RESULTS: Strong DIRECTV U.S. Performance for the Third Consecutive Quarter Drives Results” (Apr. 15, 2002) <http://www.hughes.com/ir/pr/02_04_15_earnings.xml> (visited Apr. 18, 2002).

⁵¹ 768 F. Supp. at 1083-1084.

⁵² *Merger Guidelines*, § 4 (“[e]fficiencies almost never justify a merger to monopoly or near-monopoly.”); *Heinz*, 246 F.3d at 720 (“high market concentration levels . . . require, in rebuttal, proof of extraordinary efficiencies. . .”).

A. The Promise of Local to Local in 210 Markets is Unreliable.

When the parties began to seek approval for their merger, they told Congress and the FCC that they were “constrained in offering local broadcast TV channels and other desirable programming to consumers due to constraints on scarce and limited satellite spectrum allocated by the government.”⁵³ Indeed, according to the parties, “[t]he limited channel capacity of DBS providers . . . as well as the burdens to be imposed upon that capacity in the form of satellite must carry, continue to limit DBS’s ability – *even with the implementation of spot-beam satellites and other new technologies* – to offer local programming to many consumers . . . confin[ing local-to-local service] only to the relatively large metropolitan areas.”⁵⁴ Because of this capacity constraint, the Applicants claimed that the highest number of DMAs to which each could provide local-to-local service was approximately fifty and that by eliminating duplication of spectrum they could together reach 100 DMAs.⁵⁵

Now, less than four months later, and only when opposition to the merger has arisen, the parties miraculously have found a way to provide carriage of all local broadcast stations in all 210 DMAs.⁵⁶ This “miracle” supports the Petitioners’ filings, which point out that technological

⁵³ *Hearing on the Status of Competition in the Multi-Channel Video Programming Distribution Marketplace Before the U.S. House Subcommittee on Telecommunications and the Internet*, 107th Cong. (Dec. 4, 2001) at 5 (statement of Charles Ergen, Chairman & CEO, EchoStar Communications Corporation) (“Ergen House Testimony”).

⁵⁴ Consolidated Application at 29 (emphasis added).

⁵⁵ Ergen House Testimony at 6 (“The new EchoStar will expand local network television coverage from the current 42 markets the companies serve to over 100 markets, with local TV channels offered in at least one city in each state, including Alaska and Hawaii.”).

⁵⁶ Opposition at ii.

innovation is an on-going process, which has steadily expanded the number of channels that could be carried by the same DBS spectrum.

However, in reality, this “promise” is no promise at all. On February 25, 2002, the parties explained that in order to serve “*all Americans and **comply fully with mandatory carriage requirements,***” their “engineers have designed a system that enables the receipt of local channels, other entertainment services and high-speed Internet access using one consumer-friendly mini-dish.”⁵⁷ Mr. Ergen repeated this promise to Congress: “we will comply with must-carry on a single dish and carry all stations in all markets.”⁵⁸ Yet, only one day later, in its March 7, 2002 Petition for a Writ of Certiorari to the Supreme Court of the United States in the “must carry” litigation, EchoStar explicitly stated that it “*does not intend to carry all channels in every market* unless the decision below is upheld.”⁵⁹ Explaining this reversal, EchoStar has since said that it will carry all stations that have “meaningful local content”⁶⁰ – a subjective criterion that could be used to exclude all stations other than established network affiliates.

Nor should EchoStar’s promise of a single dish to receive all local channels be given credence. In the very same Opposition filing where it prominently promises “one consumer-friendly mini-dish”⁶¹, buried in the back of the document, it urges the Commission to reject a

⁵⁷ *Id.* at 4 (emphasis added).

⁵⁸ Testimony of Charles W. Ergen before the Senate Judiciary Committee, March 6, 2002.

⁵⁹ Satellite Broadcasting and Communications Ass’n *et al.*, Petition for Writ of Certiorari, *Satellite Broadcasting and Communications Ass’n v. FCC*, 70 U.S.L.W. 3580, at 8 n.2 (U.S. Mar. 7, 2002) (No. 01-1332)

⁶⁰ Letter from Karen Watson of EchoStar to Congress, March 15, 2002.

⁶¹ Opposition at 4.

condition requiring it to offer all local stations on one dish, and makes plain that it has “forcefully contested” any such requirement and continues to do so.⁶²

Finally, EchoStar has set no meaningful deadline for when its (in any event unenforceable) promise of 210-market carriage would be achieved. While EchoStar says that it would implement this “promise” starting “as soon as” two years after approval of the merger, there is not even a paper promise of when the 210-market plan would be fully implemented.

This behavior is consistent with EchoStar’s past behavior toward broadcasters, which shows a pattern of attempts to evade its commitments and responsibilities. Among recent such instances are:

- Continuing violations of the Distant-Signal compulsory license.
- Repeated violations of must carry obligations under SHVIA.⁶³
- Placement of disfavored local broadcast stations on a satellite requiring subscribers to install a second dish for reception, which the Media Bureau held violates both Commission rules and SHVIA.⁶⁴
- A Commission finding of lack of candor by EchoStar in the Young Broadcasting retransmission consent case.⁶⁵

⁶² *Id.* at 140-141.

⁶³ See, e.g., *In re Long Family Partnership*, DA 02-231 (CSB Jan. 29, 2002) (North Carolina station “is entitled to mandatory carriage on EchoStar’s satellite system”); *In re Christian Television Corp.*, DA 02-229 (CSB Jan. 28, 2002) (Florida station entitled to mandatory carriage); *In re KM Television of Flagstaff, L.L.C.*, DA 02-221 (CSB Jan. 25, 2002) (Arizona station “entitled to mandatory carriage on EchoStar’s satellite system” under SHVIA).

⁶⁴ See *In re National Association of Broadcasters and Association of Local Television Stations*, DA 02-765, CSR-5865-Z, at 2 (Media Bureau Apr. 4, 2002) (“we find that EchoStar’s offer of a ‘free dish’ has not been implemented as such, and, in these instances, constitutes a violation of

- EchoStar and DIRECTV’s failure to comply with the Commission’s information request in this proceeding and violation of the Commission’s ex parte rules by failing to file a required notice on a timely basis.⁶⁶

As the Media Bureau said in recounting three earlier episodes involving EchoStar:

“EchoStar has previously been fined by the Commission for rule violations and admonished for its ‘disingenuous’ behavior and lack of candor.”⁶⁷ Based on EchoStar’s historical record and almost instantaneous “take-back” of its local-to-local “promise”, the Commission should not credit the Applicants’ representation that they will offer local-to-local in all 210 DMAs.

B. Less Anticompetitive Alternatives Are Available to Achieve Local-to-Local Service in All 210 Markets.

1. Each Party Separately Could Offer Local-to-Local Service in all 210 Markets

Broadcasters prefer to rely on market forces to drive local-to-local carriage rather than EchoStar “promises” for the reasons described above. As the attached Supplemental Declaration of Richard G. Gould (Appendix B) again demonstrates, each party could offer local-to-local

the statutory and regulatory prohibition of providing access to certain stations at a discriminatory price.”).

⁶⁵ “EchoStar’s conduct in filing material with the Commission requesting confidentiality, while concurrently engaging in a public debate over the issues raised in this proceeding and publicly disclosing selected portions of the alleged confidential material, constitutes an abuse of the Commission’s processes.” *In re EchoStar Satellite Corp. v. Young Broadcasting*, 16 F.C.C.R. 15,070, 15,075-76 (Aug. 6, 2001) (“EchoStar failed in its duty of candor to the Commission”).

⁶⁶ Letter from W. Kenneth Ferree, Chief, Cable Services Bureau, to Pantelis Michalopoulos, Counsel for EchoStar and Gary Epstein, Counsel for DIRECTV, March 7, 2002.

⁶⁷ *In re National Association of Broadcasters and Association of Local Television Stations*, DA 02-765, CSR-5865-Z, at 19 n.116 (Media Bureau Apr. 4, 2002).

service in all 210 markets separately. Rivalry between the parties gives them a strong incentive to continue to expand their local offerings as quickly as possible -- as reflected in DirecTV's announcement in December that it would get the jump on EchoStar by adding 10 new markets during 2002 that EchoStar does not serve.⁶⁸ The parties themselves acknowledge that DIRECTV alone will have the technical capacity to serve 103 DMAs with local-to-local service once its promised launch of DIRECTV 7S takes place -- although they now claim, incredibly, that having designed and launched the satellite to serve 103 DMAs, they will not bother using that state-of-the-art capacity in 33 of the markets for which it is designed.⁶⁹

The assertion that DIRECTV will serve only 70 DMAs instead of the 103 that the Applicants themselves concede is technically feasible is yet another statement the Applicants do not (and undoubtedly cannot) back up with facts. While Dr. Willig asserts that it would not be economically feasible to serve more markets⁷⁰, this assertion is not supported and makes no sense. Dr. Willig does not identify the costs of adding a local market, or even what markets are involved, or the value of the allegedly lost opportunity to offer other programming which he cites. Nor does he weigh these costs against the revenues and other benefits from adding local markets. (Crucially, Dr. Willig does not address the fact that the *major* cost of local-to-local service in the markets between 70 and 103 *would already be sunk* since, by assumption, the D 7-S satellite will be capable of serving these markets.) And the benefits of local-to-local are very large. They include, for instance:

⁶⁸ See the description of competitive jockeying in local-to-local roll-outs to date in NAB's Petition at 19-24.

⁶⁹ Opposition at 13-14.

⁷⁰ Willig Reply Declaration at 6-11.

- as much as 20 percent lift in subscribership in markets where local-to-local service is offered;⁷¹
- a 25 percent reduction in churn⁷²; and
- six dollars per subscriber per month (for programming that has zero copyright fees).

Given that the chief claim used by the Applicants to justify their merger is that only by merging can they offer local-to-local service, one would expect an analysis of the type described above. Yet the parties have failed to produce any analysis remotely of the type required. Why not?

2. The Applicants Could Form a Production Joint Venture

To the extent the parties seek efficiencies from eliminating duplicate spectrum, they can obtain them through a production joint venture. The parties may have “tried to negotiate one and failed,” but they cannot maintain it is “*inherently unworkable.*”⁷³ The parties’ 11th hour 210 market proposal is a critical acknowledgment that a joint venture is technologically and economically feasible. In fact, given that the Applicants came up with their current “miraculous” plan in a few weeks, once they saw their merger was faltering, one would expect that they could arrive at a feasible joint venture plan in an equally short period. The obstacle simply is a failure to agree on how to allocate costs and responsibilities. This failure is not sufficient reason for the

⁷¹ Fax Update, SATELLITE BUSINESS NEWS, Apr. 17, 2002 (citing DIRECTV President Roxanne Austin).

⁷² Mike Palkovic, DIRECTV Chief Financial Officer, presentation at Janco Partners 7th Annual Media and Telecommunications Conference, March 7, 2002.

⁷³ Opposition at 29 (emphasis added).

Commission to authorize a merger that will snuff out the zealous competition between two rivals that pushed each rival to offer more (and lower-priced) services to nearly 20 million households.

3. Continuing Advances in Satellite Technology Will Create "New Capacity" That Does Not Exist Today.

In its Petition, NAB showed that satellite capacity is not a static and frozen commodity but an ever-growing one, thanks to tireless work by brilliant engineers.⁷⁴ Among the developments cited by the NAB which have or will expand satellite capacity are spot beams; dishes capable of receiving signals from two or three orbital locations; compression techniques with existing equipment; expanded channel capacity possible through 8PSK with new set-top boxes; and MPEG-4 compression technology.⁷⁵ The Applicants make only a half-hearted effort to try to refute these irrefutable facts, adopting a pessimistic outlook totally at variance with the record of engineering advances in this field.⁷⁶ As NAB's technical expert, Dr. Gould, reiterates, the techniques he described to achieve higher DBS capacities "are feasible, practical, and are either here now or imminent."⁷⁷

C. Other Purported Efficiencies Are Advanced Casually with No Attempt at Rigor.

Because merging parties can easily claim efficiencies from many aspects of a merger, the Merger Guidelines properly set rigorous standards. Efficiencies must be "likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either

⁷⁴ NAB Petition at 82-89.

⁷⁵ *Id.*

⁷⁶ Opposition at 6-8.

⁷⁷ Supplemental Declaration of Richard G. Gould, April 15, 2002.

the proposed merger or another means having comparable anti-competitive effects.”⁷⁸ The Commission demands the same rigor; its “analysis focuses on demonstrable and verifiable public interest benefits that could not be achieved if there were no merger.”⁷⁹ As a result, the parties “bear the burden of showing both that the merger-specific efficiencies will occur, and that these efficiencies and any other public interest benefits sufficiently offset any harms resulting from the merger such that the Commission can conclude that the transaction is in the public interest.”⁸⁰ Dr. Willig tries to reverse this burden, claiming that the “opponents have not attempted to quantify the size of these cost savings”.⁸¹ But he has it precisely backwards, as both the Merger Guidelines and Commission and court precedent make clear.⁸²

Under the Commission’s standard, the parties’ efficiencies arguments wilt. The parties casually mention “new content”, “new programming” and “exciting new interactive services”

⁷⁸ Merger Guidelines, § 4.

⁷⁹ *In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from MediaOne Group, Inc., Transferor To AT&T Corp., Transferee*, CS Docket No. 99-251, Memorandum Opinion and Order, 15 F.C.C.R. 9816, 9883 ¶ 154 (2000) (“Public interest benefits may include merger-specific cost saving efficiencies and beneficial conditions proffered by the Applicants or by other parties, or imposed by the Commission.”); *see In the Matter of Applications for Consent to the Transfer of Control of Domestic and International Sections 214 and 310 Authorizations and Application to Transfer Control of a Submarine Cable Landing License by GTE Corp., Transferor, to Bell Atlantic Corp.*, CS Docket No. 98-184, FCC 00-221, Memorandum Opinion and Order, 14 F.C.C.R. 14,032, 14,141 ¶ 240 (2000) (claimed efficiencies “must be merger-specific, and, therefore, efficiencies that could be achieved through means less harmful to the public interest than the proposed merger cannot be considered true benefits of the merger.”).

⁸⁰ *In the Matter of Applications of Ameritech Corp, Transferor, and SBC Communications, Inc., Transferee, For Consent to Transfer Control of Corporations Holding Commission Licenses and Lines Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 5, 22, 24, 25, 63, 90, 95 and 101 of the Commission's Rules*, CC Docket No. 98-141, FCC 99-279, 14 F.C.C.R. 14,712, 14,847 ¶ 321 (1999) (“SBC-Ameritech Order”).

⁸¹ Willig Reply Declaration at ¶ 19.

available through the merger by eliminating duplicate spectrum use.⁸³ There is no attempt, however, to state with any specificity what new and innovative programming and services would be offered, much less to quantify their value to consumers or to commit to offering them.⁸⁴ These “efficiency claims are vague [and] speculative, and cannot be verified by reasonable means.”⁸⁵ They are also not merger specific, as EchoStar demonstrates – in its transaction with Vivendi Universal S.A – that it “will carry the new content and service regardless of the outcome of this proceeding.”⁸⁶ There is no reason to believe that DIRECTV, like EchoStar, cannot contract on its own to offer new programming and services.

The parties also point to unspecified volume discounts they can achieve on programming and set-top box purchases.⁸⁷ These discounts, to the extent they occur, may not be efficiencies at all, but, particularly in the case of programming, merely wealth transfers with no efficiency effect. In any event, the Applicants should already be achieving substantial and increasing cost

⁸² See Sidak Reply Declaration at ¶ 20.

⁸³ Opposition at 120.

⁸⁴ The gains from these additional services may be insubstantial due to the concept of satiation; incremental services are subject to diminishing consumer surplus gains. Sidak Reply Declaration at ¶¶ 29-33. Indeed, Mr. Ergen himself seems to hold this view. In explaining what the recently launched EchoStar VII will do, he emphasized that it would improve signal quality, before adding “... and we will have some capacity for some additional channels. Again we continue to look at channels. *There isn't a lot that we don't carry out there anymore, we carry almost everything that's out there*, but we look at a few additional channels.” Transcript of April 12, 2002 Charlie Chat, filed at the Securities and Exchange Commission, April 15, 2002 (emphasis added).

⁸⁵ SBC-Ameritech Order, 14 F.C.C.R. at 14,847 ¶ 321.

⁸⁶ Opposition at 120.

⁸⁷ *Id.* at 26.

savings in these areas because of their rapid growth.⁸⁸ In addition, the parties do not attempt to demonstrate or verify these efficiencies. These half-hearted attempts to assert efficiencies should be quickly rejected for their failure to meet the rigorous test of substantiation that should be particularly applicable in circumstances such as these, involving merger to monopoly or duopoly.⁸⁹

IV. THE APPLICANTS FAIL TO SHOW THAT A NATIONAL PRICING PLAN IS EITHER WORKABLE OR DESIRABLE.

EchoStar claims that concerns about its monopoly power in many local markets are misguided because it will offer a national pricing plan and be unable to discriminate. In reality, a national pricing plan is unworkable exactly because the parties *will* be able to discriminate. Even if the plan could be imposed, it would be anticompetitive.

It should be understood that “price” in the DBS industry includes many components, including basic and premium programming packages, installation, equipment and follow-up service charges, as well as any applicable rebates or discounts. Further, price is only relevant in terms of quantity and quality; in other words one can only be sure that two prices are equal if the number and quality of the programming services offered are identical. Not only do the Applicants fail to carry the burden of demonstrating that this could be done, their own statements and writings make clear that they intend nothing of the kind.

⁸⁸ See Sidak Reply Declaration at ¶¶ 22-24.

⁸⁹ In fact, the premium paid for DIRECTV by EchoStar suggests an expected increase in profits of \$4.9 billion of which between two-fifths and four-fifths is attributable to increased market power. Sidak Reply Declaration at ¶ 21.

A. Discrimination Is Feasible.

The parties themselves acknowledge their “ability to offer local promotions for installation and equipment” and that they have offered local promotions in “a handful of areas.... due to localized, specialized reasons...”⁹⁰ While they claim that such promotions will not undermine national pricing, it is difficult to see why they cannot do so. Installation and equipment are offered locally and prices could easily be varied by locality for both.

Further, Dr. Willig argues that Pegasus sells DIRECTV service in its territories for \$3 more than DIRECTV charges in its territories, but that EchoStar charges the same price in both Pegasus and DIRECTV territories, allegedly proving that price discrimination is inefficient.⁹¹ But, assuming the accuracy of his rendition, Dr. Willig proves too much – in fact, he proves that it would be quite feasible for New EchoStar to charge \$3 more in rural markets. If Pegasus can identify such customers, so can the merged company.

Perhaps the simplest method of discriminating against rural subscribers in non-cabled areas simply would be to offer a discount (“six months free”) to anyone who mails in their cable bill.⁹² EchoStar has offered this type of program in the past⁹³ and there is no reason it could not be done again in the future on a larger scale.

Simply reviewing recent developments demonstrates the difficulty with truly uniform national pricing. For instance, “consumers who live in smaller DMAs have already voiced concerns that they don’t want to pay \$5.99 to receive less than a full complement of network

⁹⁰ Opposition at 69, 71.

⁹¹ Willig Declaration at ¶ 93.

⁹² Sidak Reply Declaration at ¶ 45.

⁹³ Dish Network Announces Unbeatable Deal, BUSINESS WIRE, March 11, 1998.

affiliates, let alone for the dozens of channels broadcast for very large markets like Los Angeles”.⁹⁴ Similarly, DIRECTV is making YES, the new New York Yankees network, available as part of its Total Choice® monthly service to customers living in the Yes Network footprint, in and near New York City. However, in other areas, YES’ Yankee games will be carried on the DIRECTV SPORTS Pack, a completely different program package, with its own pricing.⁹⁵ It may well be that these programming decisions are reasonable, but they certainly are not a uniform national offering and lend themselves to disparate treatment of different groups of customers. It should be emphasized that economic theory predicts disparate or discriminatory pricing where levels of competition differ. In other words, one would expect that a rational company situated like a post-merger New EchoStar would charge more in rural monopoly areas than in urban duopoly settings. Therefore, the result can only be avoided with iron-clad “utility” type regulation, which is impossible in this setting for the reasons described above, among others.

B. EchoStar Acknowledges That National Pricing Is Unworkable and Insists on Exceptions.

Even EchoStar’s own words testify to the unworkable nature of a national pricing plan. The parties tout their “one rate card” plan to mean that “customers in rural America can rest assured that they will continue to pay the same monthly rate as customers in big cities where

⁹⁴ *Ergen Asks Dish Subs to Support Merger*, MULTICHANNEL NEWS, March 18, 2002, at 17.

⁹⁵ DIRECTV Press Release, “YES Network and DIRECTV Announce Network’s First Distribution Agreement” (Feb. 5, 2002) <http://www.directv.com/DTVAPP/aboutus/headline.jsp?id=02_05_2002A> (visited Apr. 18, 2002).

competition with cable companies is more prevalent.”⁹⁶ Yet in a December 2001 interview, Mr. Ergen explained that the merged firm, even with “rate regulation” from the federal government, would need to be able to price discriminate by locality: “if somebody comes in and offers a \$300 rebate to get your customers in a particular location, then you have to have the ability to respond to that.”⁹⁷

In their Opposition the Applicants make clear that their “national” pricing plan encompasses the loopholes described by Mr. Ergen:

...the effect on the profit-maximizing national pricing level would be negligible if New EchoStar were to offer in the first year of its operations only promotions of the same scope as those EchoStar and DIRECTV offered in the past. Indeed the Applicants are willing to commit to reasonable requirements to ensure that national pricing is an effective constraint on pricing behavior, **consistent with efficiency and market dictates.**⁹⁸

In other words, what the parties really want is a flexible national rate system – overseen by the government – where rural consumers will pay the same rate as their urban counterparts unless the DBS monopolist needs, “consistent with efficiency and market dictates,” to lower rates to match cable promotions in urban areas.⁹⁹ The Commission should recognize the Applicants’ scheme of government oversight as unworkable and unenforceable, and embrace Mr.

⁹⁶ EchoStar merger website <<http://www.echostarmerger.com/5030/wrapper.jsp?PID=5030-11>> (visited Apr. 18, 2002).

⁹⁷ *Ergen Makes His Case*, SATELLITE BUS. NEWS, Dec. 31, 2001, at 11.

⁹⁸ Opposition at 71 (emphasis added).

⁹⁹ Willig Declaration at ¶ 93 n.110.

Ergen's earlier call to "move away from 'the monopoly oriented, over-regulatory origins of communications policy.'" ¹⁰⁰

C. A National Price Would Be Above the Competitive Level.

Regardless of the impracticality of national uniformity, the parties claim the uniform national price would be based on urban competition with cable providers. This necessarily means that with only two MVPDs in an urban area – the merged firm and a cable company – DBS pricing would result from a duopoly, not from competitive pricing influenced by another DBS provider.

Further, as Mr. Sidak explains – and Dr. Willig does not contest – the "profit-maximizing national pricing level" that the Applicants admit they will charge would be above the duopoly price in urban areas.¹⁰¹ The reason is that the profit maximizing DBS firm would price at some point between the urban duopoly price and the rural monopoly price.

D. A Uniform National Price Would Make Coordinated Behavior Easier.

The parties argue that collusion between the merged firm and cable operators is not likely because coordination would have to occur with "as many as 10 cable MSO partners simultaneously."¹⁰² In reality, following approval of the AT&T Broadband/Comcast merger, the top four MSOs would account for 70 percent of all cable subscribers and nowhere do they

¹⁰⁰ *Competition to Cable: Hearing Before The Senate Commerce Committee* (July 27, 1998) (statement of Charles W. Ergen) (quoting Michael Powell, *Communications Policy Leadership*, 50 FED. COMM. L.J. 529, 534 (1998)).

¹⁰¹ Sidak Reply Declaration at ¶¶ 51-52.

¹⁰² Opposition at 76.

compete against one another.¹⁰³ Price coordination would certainly be much easier in an MVPD market where two firms could agree on prices to affect many dozens of DMAs across the country.

V. CONCLUSION

EchoStar and DIRECTV have proposed a merger that would create monopoly and/or duopoly conditions in an unparalleled number of local markets across the United States. The parties make only the weakest attempt to argue that the merger would not be anticompetitive and fail even to contest the overwhelming legal precedent against them.

Instead, they base their defense of what otherwise clearly would be deemed to be an anticompetitive and illegal acquisition on two “promises,” neither of which can stand up to scrutiny. First, they promise Local-to-Local in all 210 markets if the merger is allowed. But EchoStar admits that if it prevails in its attack on the carry one, carry all principle, its “promise” will be void, and refuses to commit to its supposed promise to deliver stations with a single dish. Further, this alleged benefit is achievable without the merger by each party on its own or by the two joining together in a production joint venture.

The second promise is a national pricing plan. But such a plan easily can be evaded. EchoStar itself admits that such a plan would require exceptions. Such exceptions would defeat the plan. More importantly, if the Commission agreed to EchoStar’s proposal, it would find itself enmeshed in a complex regulatory morass. This approach would defy the deregulatory will and intent of Congress in the Telecommunications Act of 1996 and reverse the Commission’s entire course of conduct complying with the 1996 Act.

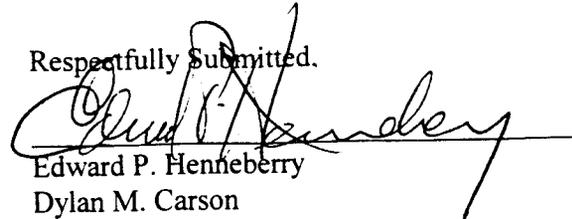
¹⁰³ Sidak Reply Declaration at ¶ 54.

In neither their initial Application nor their Opposition have the Applicants produced any credible evidence or analysis to support the positions they advance. By failing to do so, they fail to meet their burden under the public interest standard.

The Commission should reject this anticompetitive merger and allow these two highly successful companies to continue the fierce rivalry that has promoted their meteoric rise in the MVPD industry.

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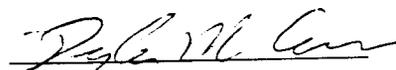
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April 25, 2002

Certificate of Service

I, Dylan M. Carson, do hereby certify that on the 25th day of April, 2002, I caused true and correct copies of the foregoing Ex Parte Reply to Opposition of the National Association of Broadcasters to be served via courier and, as indicated, electronically upon the parties on the attached service list.


Dylan M. Carson

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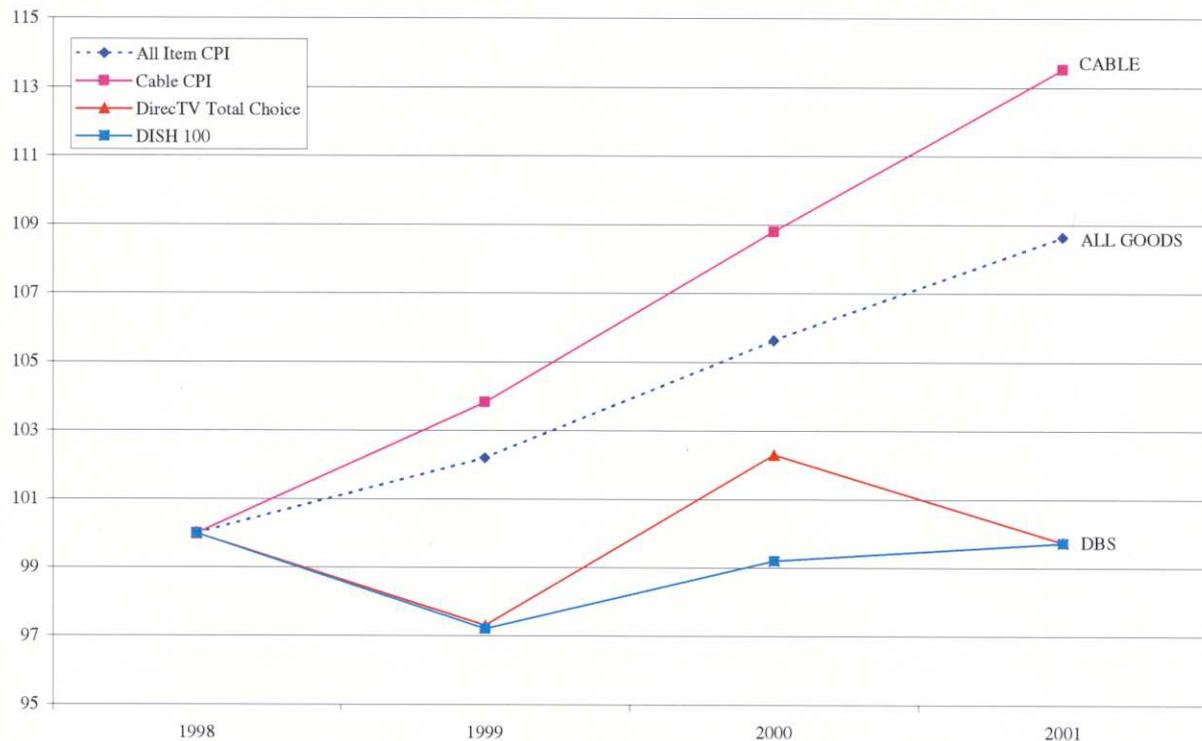
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Cable vs. DBS - Indexes of Monthly Prices Over Time



The price of DBS (including equipment and installation¹) relative to cable declined at a rate of 4.3% per year from 1998 to 2001, equivalent to roughly 13% over a three-year period. This occurred because cable prices rose while DBS equipment prices declined and service prices increased only slightly.² The increase in the price of cable service is the primary driver of the reduction in the relative price of DBS to cable. The cable CPI, a Bureau of Labor Statistics price index that accounts for the periodic service charges for various basic and premium packages as well as installation charges (but not pay-per-view movies), increased by 13.5% between 1998 and 2001, or at an average annual rate of 4.3%.³ Over the same period, prices generally (measured by the annual U.S. city average Consumer Price Index) increased at an average rate of only 2.8%, so cable prices were rising in real terms.

¹ The Yankee Group reports that the median price of a DBS system to new subscribers, including installation, fell from \$300 in 1998 to \$195 in 1999 and \$150 in 2000. This rate of decline suggests that the median price in 2001 would be expected to fall to about \$106. In fact,

anecdotal evidence suggests the comparable price for 2001 was likely some 50% lower. A price of \$50 has been used for 2001.

² Quality improvements during these years in either cable television (more channels and upgrades to digital service) or DBS service (more national channels and increased availability of a local station viewing option for local subscribers) have not been taken into account.

³ These calculations are based on the annual U.S. city average cable television CPI.

SUPPLEMENTAL DECLARATION OF RICHARD G. GOULD

The Declaration of Richard J. Barnett in behalf of EchoStar Communications Corporation, General Motors Corporation, and Hughes Electronics Corporation disputes the accuracy of several technical points made in my original Declaration on behalf of the National Association of Broadcasters. Dr. Barnett is mistaken. The points in my original Declaration are sound, and the techniques to achieve the higher DBS capacities they describe are feasible, practical, and are either here now or imminent.

As I explained in my original report, the already-accomplished technical achievements of *DirecTV and EchoStar themselves* show that each company could individually carry all of the local television stations in the United States, while having plenty of capacity left over for their current national programming (and more). In this Supplemental Declaration, I independently derive an estimate of transponder capacity and frequency re-use factor and hence the number of "carry one, carry all" local TV stations that EchoStar and DirecTV could provide independently.

A detailed DBS satellite system design would be required to predict the specific number of local stations that could be carried by each operator independently, but the estimate derived here, based on average conditions, is large enough to insure that all of the 1467 eligible local TV stations could be carried, taking into account differences in the number of eligible TV stations within each DMA and the irregular shape of DMA's.

Frequency Re-use Analysis

By using spot beam technology, it is possible to re-use the available frequency spectrum over CONUS many times. The size of the beam is determined by the satellite antenna reflector

size and the downlink frequency. The half power beamwidth is conveniently estimated by the formula

$$HPBW = \frac{21^\circ}{f D}$$

where f is the frequency in gigahertz and D is the antenna diameter in meters. For example, the DirecTV 7S satellite employs a downlink antenna reflector that is 3.5 meters in diameter. Thus at the Ku-band downlink frequency of 12 GHz, the beamwidth is 0.5° as assumed by Morgan (pp. 24 – 25). As shown in *Figure 1*, the Contiguous United States (CONUS) can be covered by a hexagonal array of 65 spot beams each having a beamwidth of 0.5° .

Spot-beams having sufficient spatial separation can share the same frequencies. To avoid self-interference, it is desirable to keep the separation as large as possible. *Figure 2* illustrates a seven-beam hexagonal cluster design, as described in the Barnett declaration (pp. 29 – 30). Beams sharing the same frequency, labeled with the same number, are separated by nearly two full beamwidths and each beam is surrounded by six beams using different frequencies. As acknowledged in the Barnett declaration, this cluster design provides a more than adequate level of beam separation to ensure an acceptable level of isolation between beams sharing the same frequency.

Dr. Barnett states that a cluster of three and four beams are impractical because the self-interference would be too high, and sets the minimum cluster size as one that provides at most two full beamwidths of separation for re-use of the same frequency. But that conclusion is too conservative by far. For example, Intelsat VI, using 20-year old technology, has 160 beams, each with a 3 dB beamwidth of 1.6 degrees; these co-frequency beams form shaped Zone Beams that are separated by only 1.4 times the individual beamwidths. That means a five-frequency

group re-use scheme would not have unacceptable self-interference and would permit a higher overall frequency re-use factor than assumed here.

The detailed design of the Astrolink satellite is an example of current beam generation technology. In that design, one-degree beams are arranged in clusters of four, without incurring unacceptable self-interference (that is, inter-beam interference).

Frequency re-use factor.

With a hexagonal array of 65 beams over CONUS and a beam cluster size of 7, the frequency re-use factor is $65/7 = 9.2$. This means that there are 9.2 beam clusters covering CONUS and that each beam within the cluster shares the same frequency with the corresponding beam in other clusters 9.2 times from a single satellite orbital slot. With the same beam configuration from two orbital slots, the re-use factor would be doubled to achieve a frequency re-use factor of 18.4. Therefore, Dr. Barnett's statement (Note 25 on page 22) that my estimate of a frequency re-use factor as high as 10 has no basis is incorrect. The above analysis shows that a factor of almost 10, that is 9.2, can be achieved from a single satellite. Furthermore, a factor twice as great, that is 18.4, is possible from two orbital slots.

Here too, again even assuming no improvements from the obsolescent technology of Intelsat VI, the assumption of sixty-five beams used here is an overly conservative number for a 12 GHz Ku-band DBS satellite with a 3.5 meter diameter transmitting antenna. Intelsat VI generates 160 beams of 1.6 degree diameter which it combines to produce its shaped Zone Beams.

Bandwidth.

For a given information bit rate R_b , the required bandwidth B is given by

$$B = k \frac{R_b}{m r}$$

where k is the spectral shaping factor, m is the number of bits per symbol, and r is the code rate. Assuming 20 percent raised cosine filtering ($k = 1.2$), QPSK modulation ($m = 2$), and rate $3/4$ forward error correction coding, this equation implies $B = 0.8 R_b$. With modern compression¹ techniques, the required average information bit rate for a standard NTSC television channel is between 2.5 Mbps and 3.0 Mbps.

The individual television channel data streams are combined to form a single data stream by the process of multiplexing. By using a single carrier, the transponder can be operated at maximum power without incurring intermodulation effects among individual channels and the bandwidth utilization can be maximized by eliminating the need for guard bands between channels. The data rate for a particular channel depends on the level of detail in the TV picture and changes with time. Through the technique of “statistical multiplexing,” the instantaneous information data rates of the individual channels can be varied dynamically in real time to allocate bits where they are most needed. The value of 3.0 Mbps or less is an average, which has been well established in the industry. Furthermore, the satellite operators can organize transponder channel content to provide a mix of high data rate and low data rate channels to optimize the transponder capacity. By stating that a transponder channel capacity of 12 “is not possible for all types of TV programs, depending on their picture content” (p. 10), Barnett seems to assume that the same data rate is assigned to every channel, thus not recognizing that the assumed data rate is an average over all channels and ignoring the use of statistical multiplexing.

The bandwidth of a DBS satellite transponder is 24 MHz. With a data rate of between 2.5 Mbps and 3.0 Mbps, the required bandwidth per channel is approximately between 2.0 MHz

¹ The term “compression” refers to the reduction in the necessary information bit rate achieved by exploiting both spatial and time redundancies in the TV picture content. The information bit rate of an uncompressed NTSC digital signal according to the ITU-R Rec. 601 standard is 216 Mbps. Through compression, this high data rate can be reduced to approximately 3.0 Mbps on average, depending on the information content of the TV picture.

and 2.4 MHz. Therefore, with industry standard QPSK modulation, the transponder channel capacity² is approximately between 10 and 12 NTSC television channels. A capacity of 10 NTSC channels per transponder is a conservative estimate that is acknowledged in the Barnett declaration (p. 9) as an achievable level today. A capacity of 12 NTSC channels per transponder is not only possible, but is acknowledged (p. 10) to be in use by both DirecTV and EchoStar in selected regions. Improvements in compression, coding, and statistical multiplexing techniques will continue to enhance the practicality of this level of capacity.

Further confirmation of the expected increase in the number of typical TV programs that can be multiplexed into a single digital carrier, and carried in one transponder of a DBS satellite without degradation of video or audio quality was provided just recently at the 2002 television trade show in Las Vegas, Nevada. The consensus expressed there by the leading manufacturers of the encoding, pre-processing and multiplexing equipment used by DBS broadcasters is that 11 programs per transponder is available now, and that another 10% improvement would be achieved in another 18 months, resulting in the ability to carry a mix of 12 typical programs on a single transponder.

Dr. Barnett is mistaken when he states that "Petitioners appear to have ignored the fact that approximately 20% of the available bandwidth on every transponder in the network is needed for non-video purposes....The compression systems require available 'headroom' within the overall bit stream within every transponder...to perform their compression and multiplexing functions...and one transponder at every satellite location includes a complete Electronic Program Guide [requiring] one third of the available capacity of [the] home transponder."

² The term "transponder channel capacity" refers to the number of NTSC television channels that can be transmitted in a single transponder frequency bandwidth. The unfortunate use of the term "compression ratio" by Barnett and

On the contrary, only about 1.9 MB/s out of the total transponder bit rate capacity (not bandwidth as Dr. Barnett has argued) of 27 MB/s is required for "overhead." That is, Conditional Access messages (ECM's and EMM's) require about 1.45 MB/s, while Program Specific Information requires less than 0.5 MB/s. All told, that overhead takes up only about 7% of the capacity of a transponder. The stereo audio accompanying each video channel requires only about 0.128 MB/s. Additional stereo radio channels also require only 0.128 MB/s. The Electronic Program Guide requires about 4 MB/s, but it is transmitted on only one transponder of the satellite at each location.

Further improvements are achievable from such techniques as better QPSK modulator designs which provide better discrimination between the four quadrature states (which would permit the use of less error correction coding and hence increase effective capacity).

Required number of frequencies.

There are 1467 local TV stations distributed among 210 DMAs. The average number of stations per DMA is $1467/210$, or approximately 7 stations per DMA. Assuming that 65 beams are required to cover CONUS, the average number of DMAs per beam $210/65$, or approximately 3 DMAs per beam. Thus there are on average about $7 \times 3 = 21$ stations per beam.

If the transponder capacity is conservatively assumed to be 10 NTSC channels, the number of transponders required to provide all 1467 local TV stations is $1467/10$, or 147 transponders. With a frequency re-use factor of 9.2, the resulting number of required frequencies is $147/9.2$ or approximately 16. If the transponder capacity is 12 NTSC channels, the required number of transponders is $1467/12 = 122$. With a frequency re-use factor of 9.2, the required number of frequencies is 13.

some other authors is incorrect, as the term "compression" refers to the reduction in information bit rate by exploiting redundancy as explained in Note 1.

The typical transponder RF power is 100 W. The total RF power required is thus about 15 kW. However, as the typical amplifier efficiency is on the order of 50%, the total payload power required is roughly 30 kW. Therefore, it would be reasonable to assume that two high-power satellites at a single orbital slot could provide coverage for all 1467 local TV stations. In practice, the coverage might be allocated among several satellites to optimize transponder bandwidth and power for both local TV stations using spot-beams and national coverage using CONUS beams.

It should be emphasized that these frequency and power estimates are approximate values to demonstrate the feasibility of providing all local TV channels with existing satellite technology. A detailed analysis is necessary to take into account variations in the geographical size and shape of the DMAs, and the number of TV stations per DMA. However, since most of the individual assumptions used in this analysis are highly conservative, the actual number of local TV stations that could be carried through a detailed design will be at least the 1457 needed to serve all 210 US DMA's.

Use of higher order modulation.

In the past, satellite communications systems were constrained by the level of power available on relatively modest satellites. However, with the development of modern high power satellites, available power is no longer nearly as important a constraint. Therefore, there is a significant trend toward better spectral efficiency using higher order forms of modulation.

With 8PSK modulation, there are 3 bits per symbol instead of 2 bits per symbol as with QPSK modulation. Consequently, for a given data rate R_b , the required bandwidth using 8PSK is 2/3 the bandwidth using QPSK. The permissible data rate R_b for a given bandwidth is

$$R_b = m r \frac{B}{k}$$

Since $m = 3$ for 8PSK and $m = 2$ for QPSK, the information bit rate using 8PSK is $3/2$ the information bit rate using QPSK. Thus 8PSK affords a 50% increase in information data rate. Therefore, the resulting transponder capacity is between 15 and 18 NTSC channels using 8PSK modulation.

The tradeoff for reduced bandwidth using 8PSK modulation is higher power. Compared to QPSK, the power required with 8PSK is about 3.5 dB higher for a typical bit error rate. This value corresponds to an increase in power by a factor of 2.2. That is, 8PSK requires somewhat in excess of twice the power as QPSK (p. 14). The use of sophisticated methods of coding, such as turbo codes combined with 8PSK trellis-coded modulation, can reduce the power requirement without materially increasing the necessary bandwidth.

While satellite power was indeed at a premium in past years, the evolution of satellites has made the possibility of using 8PSK and other spectrally efficient methods of modulation a practical reality. Therefore, it is likely that in the near future even greater transponder capacity using more efficient methods of modulation will be realized because of the growth in satellite power.

Conclusions

Barnett (pp. 1-2) summarizes three criticisms of the Petitioners' arguments.

First, he states that the capacity estimates rely on unproven or impractical improvements to technology. On the contrary, we have shown that using beams produced by a typical existing satellite antenna reflector and Barnett's own example of a valid beam cluster design that a frequency re-use factor of 9.2 could be achieved from a single orbital slot and that the entire population of 1467 local TV stations could in principle be provided using only 16 frequencies, even if one assumed carriage of only 10 stations per frequency. And even if one assumed that

the DBS firms merely replicated the relatively low 7.33 re-use rate that DirecTV achieved with the D 4-S satellite, each firm could carry all 1467 local TV stations with only 17 frequencies (assuming carriage of 12 stations per frequency).

Second, Mr. Barnett challenges the satellite design concepts. In fact, the analysis has been (conservatively) based on existing satellite technology. The Boeing 702 satellite, for example has a total power of 15 kW and can carry 100 transponders. Two 702 satellites at a single orbital slot could provide the bandwidth and power required to provide service to all 1467 local TV stations.

Third, Mr. Barnett criticizes the emphasis on local programming at the expense of future national programming. But that criticism misses the point. It is tautologically true -- but uninteresting -- that a DBS firm could carry larger quantities of one type of programming if they carried less of another type of programming. But as I showed in my previous Declaration, and as this Declaration confirms, each firm has plenty of capacity to carry all of its existing national programming, all local stations, and even some new national programming, without relying on any new technologies. And with use of such advanced techniques as 8PSK, each firm could carry still more.

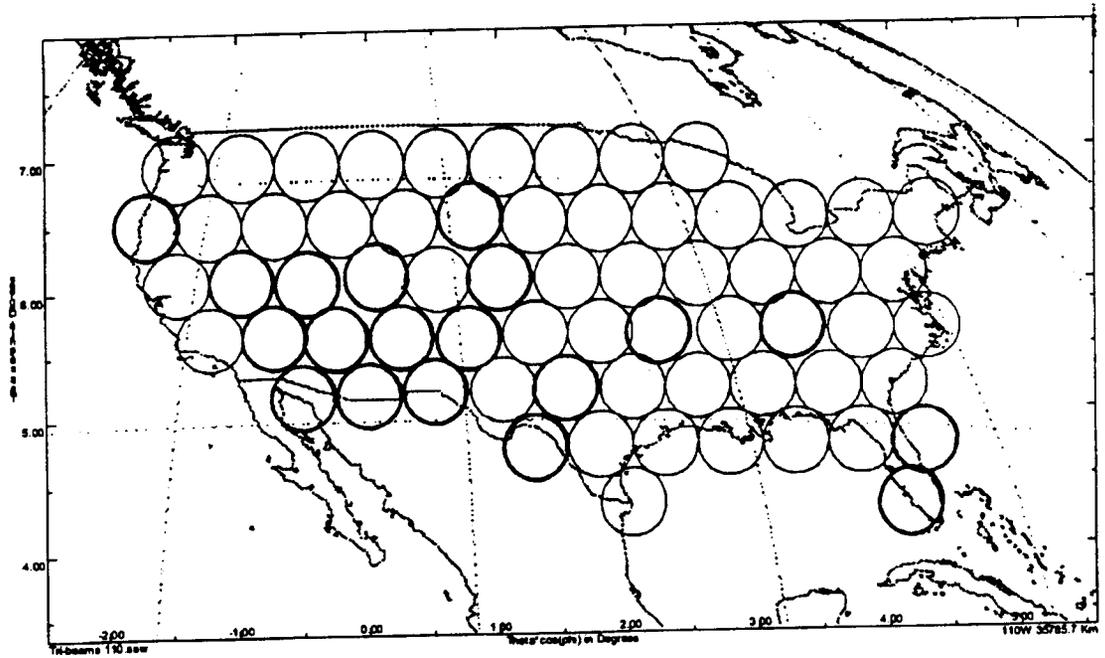


Figure 1. CONUS covered by 65 0.5° beams (adopted from Morgan declaration, Figure 5, p. 25).

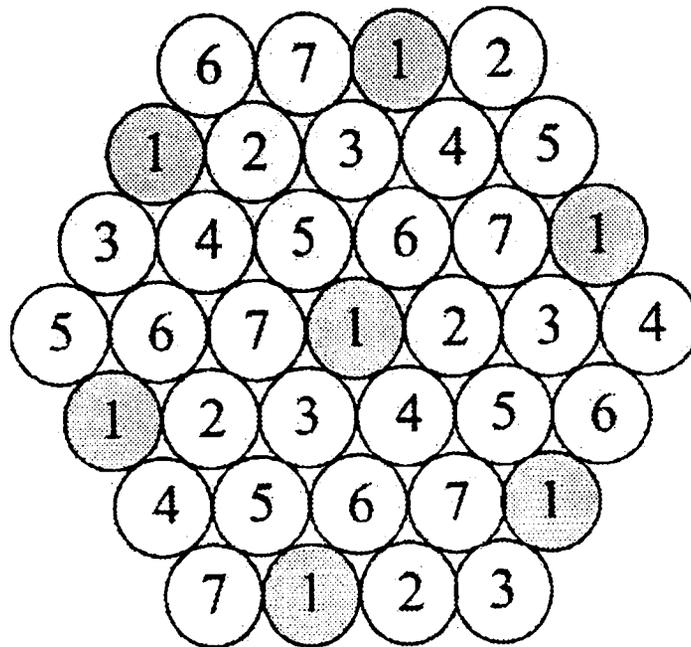


Figure 2. Seven-beam frequency re-use cluster (after Barnett declaration, Figure 4, p. 30).

I hereby declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge.



Richard G. Gould

Executed April 15, 2002.

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

Application of)
)
EchoStar Communications Corporation,)
General Motors Corporation,)
Hughes Electronics Corporation,)
)
Transferors) CS Dkt. No. 01-348
)
and)
)
EchoStar Communications Corporation,)
)
Transferee,)
)
For Authority to Transfer Control)

REPLY DECLARATION OF J. GREGORY SIDAK

Introduction

Qualifications

Summary of Conclusions

- I. Professor Willig Fails to Quantify His Estimates of Anticompetitive Effects and Potential Efficiencies
 - A. Professor Willig Offers No Probative Evidence Regarding the Extent to Which DIRECTV and EchoStar Constrain Each Other's Prices
 1. Professor Willig Has Changed His Position and Now Concedes That DIRECTV and EchoStar Compete
 2. The Customer Data That Professor Willig Cites Are Uninformative
 3. Professor Willig's Justification for Examining the Effects of the Proposed Merger between EchoStar and DIRECTV at the National Level Is Not Valid and Is Not Consistent with His Reasoning in Other Regulatory Matters

CRITERION ECONOMICS, L.L.C.

- B. DIRECTV and EchoStar Bear the Burden of Demonstrating That the Proposed Merger Would Produce Efficiencies
 - 1. Professor Willig Fails to Quantify The Claim of Programming Savings
 - 2. Professor Willig Presents No Evidence that the Offer of Local Services in All 210 DMAs Would Be a Merger-Specific Efficiency
 - 3. The Welfare Gains Associated with the Introduction of Additional Services May Be Insubstantial

- II. The National Pricing Plan Is Not a Viable Safeguard
 - A. The Commission Cannot Rely Upon Professor Willig's Analysis Because There Is No Assurance that the Merged DBS Firm Would Not Discriminate Against Rural Customers
 - 1. EchoStar Would Reserve the Right to React to Local Promotions by Cable Television Operators
 - 2. Because of the Multiple Ways That DBS Firms Compete on Price and Non-Price Dimensions, a Uniform National Pricing Plan Would Be Impossible to Enforce
 - a. The Merged DBS Firm Could Vary the Price of Equipment or Installation, or Both
 - b. The Merged Firm Could Offer Rebates to Customers Who Mail in Their Cable Bills
 - c. The Merged Firm Could Reduce the Number of Channels for Customers in Areas without Cable Television Service
 - d. The Merged DBS Firm Could Vary the Price of Local Broadcast Channels
 - B. Even If the Merged DBS Firm Did Not Discriminate Against Rural Customers, DBS Consumers in Urban Areas Would Face Higher Prices
 - 1. The Post-Merger Uniform Price Would Exceed the Pre-Merger Discriminatory Price in Areas with Cable Television Service and Would Likely Exceed the Pre-Merger Discriminatory Price in Areas without Cable Television Service
 - 2. The National Price Would Facilitate Collusion with Cable Television System Operators

Conclusion

INTRODUCTION

1. When presented with the actual evidence of price competition between the two direct broadcast satellite (DBS) service providers, DIRECTV and EchoStar, Professor Robert D. Willig has modified his position substantially and supplemented his analysis. Before, based on

representations made to him by the DBS companies, he rejected the possibility of competition between DIRECTV and EchoStar. Now, Professor Willig acknowledges a “degree” of competition between DIRECTV and EchoStar. Before, he dismissed any anticompetitive effects. Now, Professor Willig invites the Commission to perform the following tradeoff: accept known consumer welfare losses today in exchange for unknown, unproven, and non-quantified efficiencies tomorrow. In doing so, he fails to carry the burden of demonstrating that the proposed merger’s anticompetitive effects would be outweighed by any efficiency gains. The Commission should decline Professor Willig’s invitation and instead should, as I proposed in my initial declaration, block the proposed merger.¹

QUALIFICATIONS

2. My name is J. Gregory Sidak. I am the F.K. Weyerhaeuser Fellow in Law and Economics Emeritus at the American Enterprise Institute and the president and chief executive officer of Criterion Economics, L.L.C., in Washington, D.C. I have been a consultant on regulatory and antitrust matters to the Antitrust Division of the U.S. Department of Justice and the Canadian Competition Bureau and to more than forty companies in the telecommunications, computer software, electric power, natural gas, mail and parcel delivery, broadcasting, newspaper publishing, recorded music, and financial services industries in North America, Europe, Asia, and Australia.²

1. Declaration of J. Gregory Sidak on behalf of the National Association of Broadcasters, CS Dkt. No. 01-348 (filed Feb. 4, 2002) [hereinafter *Sidak Declaration*].

2. My complete biography appears in my initial declaration. *See id.* at 3 ¶¶ 2-6.

3. I file this declaration in my individual capacity as a consultant to the National Association of Broadcasters and not on behalf of the American Enterprise Institute, which does not take institutional positions on specific regulatory, adjudicatory, legislative, or executive proceedings.

SUMMARY OF CONCLUSIONS

4. In this reply declaration, I evaluate arguments that Professor Willig made in his reply declaration on behalf of EchoStar and DIRECTV.³ Mergers that reduce the number of competitors from 3 to 2 or from 2 to 1, such as the proposed EchoStar-DIRECTV merger, are highly likely to have anticompetitive effects, as my initial declaration and those of Professors Paul W. MacAvoy and Daniel Rubinfeld demonstrated.⁴ Only if such a merger results in “extraordinary efficiencies” can these anticompetitive effects be overcome.⁵ Professor Willig has failed to present specific analysis to counter either the presumption of anticompetitive effects or the estimates of the likely magnitude of such effects furnished in my initial declaration and the declarations of others, despite the fact that such data are within the control of EchoStar and DIRECTV. EchoStar and DIRECTV have failed to come forth with quantified estimates of post-merger efficiencies that would allow one to understand their countervailing impact, if any, on the predicted price increase.

3. Reply Declaration of Robert D. Willig on behalf of EchoStar Communications Corp., General Motors Corp., and Hughes Electronics Corp. (filed Feb. 25, 2002) [hereinafter *Willig Reply Declaration*].

4. Declaration of Paul W. MacAvoy on behalf of the National Rural Telecommunications Cooperative, CS Dkt. No. 01-348 (filed Feb. 1, 2002); Affidavit and Report of Daniel Rubinfeld on behalf of Pegasus Communications, CS Dkt. No. 01-348 (filed Feb. 4, 2002).

5. *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 720 (D.C. Cir. 2001).

5. In Part I, I rebut Professor Willig's characterization of the proposed merger as procompetitive. I show that Professor Willig has not offered credible analysis of the extent to which DIRECTV and EchoStar constrain each other's prices. The customer churn data on which Professor Willig relies are uninformative. I also show that Professor Willig and the DBS companies have failed to substantiate in any way the claimed efficiencies of the proposed merger, as is their burden, whether in the nature of cost savings or in the introduction of new services, and that the welfare gains from such efficiencies, if any, may be insubstantial.

6. In Part II, I show why the offer by EchoStar and DIRECTV to charge a uniform national price plan is not a panacea. The Commission cannot rely upon Professor Willig's analysis because it offers no assurance that the merged DBS firm would refrain from discriminating against rural DBS customers. Professor Willig's analysis ignores EchoStar's insistence that the merged DBS firm have the flexibility to respond to local promotions by cable television system operators. EchoStar's pledge not to price discriminate against rural customers is an empty promise. Moreover, on price and non-price dimensions a national pricing plan would be impossible for the FCC to enforce.

7. Finally, even if the merged DBS firm refrained from discriminating against customers in areas without cable television service, such a plan would be anticompetitive. The post-merger national price would exceed the pre-merger price in areas with cable television service. Furthermore, the national price would make it easier for the merged DBS firm to collude with cable television system operators.

I. PROFESSOR WILLIG FAILS TO QUANTIFY HIS ESTIMATES OF ANTICOMPETITIVE EFFECTS AND POTENTIAL EFFICIENCIES

8. Professor Willig does not support his assertion that the proposed merger would be procompetitive on balance. His rebuttal of my analysis of the anticompetitive effects of the proposed merger relies on churn data that in no way counter the presumption that this merger, resulting in highly concentrated local markets, would be anticompetitive. Similarly, Professor Willig's attempt to show procompetitive efficiencies fails because it is limited to vague assertions with no attempt to quantify their worth to consumers. Thus, the DBS firms and their expert fail to carry their burden of proof that the proposed merger would not have an anticompetitive effect or that the anticompetitive effects would be overcome by countervailing efficiencies.

A. Professor Willig Offers No Relevant Analysis Regarding the Extent to Which DIRECTV and EchoStar Constrain Each Other's Prices

9. Professor Willig's initial declaration did not present any empirical evidence to support his claim that EchoStar and DIRECTV do not compete. In his reply declaration, Professor Willig presents survey data that purportedly represent (1) the choices of former DIRECTV customers and (2) the choices of new DIRECTV customers. After reviewing the data, I conclude that the churn data do not support Professor Willig's assertion that DIRECTV does not exert pricing pressure on EchoStar (and vice versa).

1. Professor Willig Has Changed His Position and Now Concedes That DIRECTV and EchoStar Compete

10. In his initial declaration, Professor Willig asserted that DIRECTV did not consider EchoStar's price when forming its own price (and vice versa).⁶ Faced with massive new evidence that contradicted what EchoStar and DIRECTV managers told him, Professor Willig modified his assessment of competition between DIRECTV and EchoStar:

[The commenters] argue that if [DIRECTV and EchoStar] compete at all, the merger will have a significant and adverse effect on competition in the [multichannel video programming distribution (MVPD)] market. The more relevant question for analyzing the impact of the merger on competition in the MVPD market, however, is not whether they compete at all. Rather, it is the *degree* of competition between DIRECTV and EchoStar in a market including DBS providers, cable operators, other MVPD providers, and perhaps even broadcast television.⁷

Professor Willig has changed his position but continues to minimize the extensive competition between the DBS companies. He attempts to dismiss three of the eight anecdotes of head-to-head DBS competition that I presented by suggesting that other events, such as the passage of the Satellite Home Viewer Act, could have provided the impetus for the firms' correlated pricing and marketing behavior.⁸ The fact that outside factors may have been the impetus for the timing of particular competitive announcements does not mean that they are not instances of competitive behavior. In any event, Professor Willig's failure to address the remaining five anecdotes of documented competition between DIRECTV and EchoStar speaks for itself.

6. Declaration of Robert D. Willig on behalf of EchoStar Communications Corp., General Motors Corp., and Hughes Electronics Corp. ¶ 11 & n.5 (filed Dec. 3, 2001) (claiming that a DBS firm focuses on cable prices and that the other DBS provider "plays little (if any) role in their own pricing decisions") [hereinafter *Willig Declaration*].

7. *Willig Reply Declaration*, *supra* note 3, ¶ 59 (emphasis added).

8. *Id.* at ¶ 57-58.

2. The Customer Data That Professor Willig Cites Are Uninformative

11. In addition to modifying his opinions on the existence of competition between DIRECTV and EchoStar, Professor Willig supplements his earlier analysis. In his initial declaration, Professor Willig did not present any empirical evidence that DIRECTV and EchoStar fail to constrain each other's prices. In his reply declaration, Professor Willig now advances two surveys: (1) a survey conducted by DIRECTV of its new subscribers and (2) churn data of former DIRECTV subscribers. According to the survey of new subscribers, nine percent of DIRECTV's new subscribers previously subscribed to EchoStar, but 61 percent of new DIRECTV subscribers are either previous or current cable television subscribers. Professor Willig notes that "[a]lthough such figures are not necessarily conclusive, they confirm the views expressed by DBS executives—namely that the 'objective of each firm is to gain market share by luring consumers away from the leading cable providers,' not the customers of the other DBS firm."⁹ Because the sample was less than 100 DIRECTV customers, or less than one one-thousandth of one percent of all DIRECTV customers, the survey results cannot be used to support the claim that DIRECTV does not constrain the pricing of EchoStar. Moreover, the small number of former EchoStar subscribers among DIRECTV's current subscribers may be attributable to the fact that DBS service is relatively new and EchoStar did not enter the market until two years after DIRECTV.

12. Next, Professor Willig cites two sets of churn data of former DBS customers (one for August through November of 2000, and another for 2001) to support his claim that DIRECTV and EchoStar do not compete on the basis of price:

9. *Id.* ¶ 61 (quoting *Willig Declaration*, *supra* note 6, ¶ 10).

Among those subscribers sampled who disconnected between August 2000 (when the price increase was announced) and November 2000 and cited cost/price issues as their main reason for departing DIRECTV, 3.1 customers churned to cable and 1.2 customers churned to an antenna for every one customer who churned to EchoStar. One potential concern with this analysis is that the sample size is relatively small (under 100 respondents). Nevertheless, such evidence provides support for the conclusion that there is only limited competitive interaction between the two DBS firms.¹⁰

The churn data are not illustrative for several reasons. First, the survey respondents had the opportunity to switch to cable television service—but for approximately 29 percent of all DIRECTV customers, cable television is not a viable option.¹¹ Indeed, for some customers in rural areas, over-the-air broadcast television is not an option. For customers without access to cable television service, the survey is not informative.

13. Second, the small sample size in the first survey leads to unreliable results. In particular, a small sample tends to increase the sampling error, which is the difference between the sample and the population that exists only because of the observations that happened to be selected for the sample.¹²

14. Third, the amount of time that passed since the date on which the customer disconnected service could significantly alter the results of the churn survey. Because a DBS customer may keep an antenna in his home, such a customer may find it easier to use the antenna as a short-term solution than to order cable television service or DBS service from another provider. If the former DBS customer were surveyed too soon after disconnecting, then one would expect that customer to have switched from DBS service to over-the-air broadcast service.

10. *Id.* ¶ 63. The 2001 DIRECTV churn data cited by Professor Willig lists 3.4 customers churning to cable and 1.6 to antenna for every one who churns to EchoStar. *Id.* ¶ 64.

11. Comments of DIRECTV, Inc., Annual Assessment of the Status of Competition in the Markets for the Delivery of Video Programming, CS Dkt. No. 01-129 (filed Aug. 3, 2001) [hereinafter *DIRECTV Comments*].

12. *See, e.g.*, GERARD KELLER & BRIAN WARRACK, STATISTICS FOR MANAGEMENT AND ECONOMICS 170 (Duxbury Press 4th ed. 1997). For a review of sampling variance, see WILLIAM H. GREENE, ECONOMETRIC ANALYSIS (MacMillan Publishing 2d ed. 1990)

15. Fourth, although Willig restricts his analysis to churn data for customers who cited a “cost or price reason” for leaving DIRECTV, such a reason cannot be interpreted with certainty as the proper economic experiment for determining the cross-price elasticity of demand. In particular, Professor Willig provides no evidence that, for the first set of churn data, the price of DIRECTV increased *while the price of EchoStar was held constant*. More likely, because DBS prices move in unison, the price of EchoStar’s offering increased at roughly the same time, thereby making DBS in general less attractive than cable television service. Indeed, if consumers perceived DIRECTV and EchoStar to be perfect substitutes, and if the price of DIRECTV and EchoStar increased simultaneously, then one would expect DBS customers to churn to cable television. Hence, the churn data presented by Professor Willig are consistent with the hypothesis that consumers perceive DIRECTV and EchoStar to be perfect substitutes.

16. Fifth, even setting aside the above faults, the churn data still are relevant only to the degree to which an *existing* DBS customer perceives DIRECTV and EchoStar to be substitutes. When measuring the cross-price elasticity of demand, however, economists seek to ascertain the degree to which a *potential* customer perceives two goods to be substitutes. Because the DIRECTV churn data reveal nothing about the degree to which cable television customers or broadcast television customers perceive DIRECTV and EchoStar to be substitutes, Professor Willig’s churn analysis cannot inform the Commission on the matter of the cross-price elasticity of demand.

17. Sixth, broadcast television should not be included in every local MVPD market. For homes that cannot receive a clear signal from a rooftop antenna, broadcast television is not an option. Moreover, it is unlikely that a hypothetical monopoly provider of cable television service and DBS service would need to control the supply of broadcast television service to raise

prices above the competitive levels.¹³ Indeed, because broadcast television service is essentially free to individuals who already own a television set, Professor Willig's argument is equivalent to the claim that, because soda drinkers occasionally "churn" to tap water, a hypothetical monopoly provider of soda would need to control the supply of free tap water to raise soda prices above the competitive level. In summary, Professor Willig is obscuring the key fact about competition—that it occurs at the margin.

3. Professor Willig's Justification for Examining the Effects of the Proposed Merger between EchoStar and DIRECTV at the National Level Is Not Valid and Is Not Consistent with His Reasoning in Other Regulatory Matters

18. In his initial declaration, Professor Willig argued that the relevant geographic market was the nation because the DBS firms priced their offerings in a uniform fashion.¹⁴ In his reply declaration, Professor Willig stated that Pegasus, a retailer for DIRECTV in rural areas, charged an additional \$3 above DIRECTV's own monthly subscription fee.¹⁵ Because prices for DIRECTV service vary according to geographic area, Professor Willig's rationale for analyzing the competitive effects of the proposed merger at the national level is not valid. Later, in his reply declaration, Professor Willig agrees with me that the merged DBS firm would formulate its uniform price based on a weighted average of the competitive conditions in each local DBS

13. U.S. Dept. of Justice and Federal Trade Commission, Horizontal Merger Guidelines §§ 1.1 (rev. Apr. 8, 1997) [hereinafter *Merger Guidelines*].

14. *Willig Declaration*, *supra* note 6, at 11, ¶ 19 ("Finally, for the purposes of evaluating the competitive impact of the proposed merger, the national pricing for monthly subscription and programming fees by both EchoStar and DIRECTV suggest that a national-level analysis is the most appropriate . . .").

15. *Willig Reply Declaration*, *supra* note 3, at 61, ¶ 93.

market.¹⁶ That concession by Professor Willig undermines his claim that the relevant geographic market is national.¹⁷

19. Indeed, in a separate expert declaration filed on behalf of AT&T in February 2002, Professor Willig argues that competition in the broadband Internet market should be evaluated at the local level, especially in local areas not served by cable television service:

[I]t is not enough to look at national statistics about DSL and cable modem subscriptions. Nationally, cable modem subscriptions have outpaced DSL subscriptions by nearly two to one . . . If one looks at smaller geographic markets, the differences are even more pronounced, for there are areas where cable service is not available at all, just as there are areas without DSL service . . . Thus, even if the Commission were to conclude that the ILECs lack market power in neighborhoods served by both DSL and cable, that analysis would not apply to the areas and customers who do not have such competitive choices.¹⁸

It is unclear why Professor Willig believes that competition in the market for broadband Internet services should be examined at the local level (when his client is seeking regulatory actions) while competition in the market for MVPD services should be examined at the national level (when his client is seeking de-regulatory actions).

B. DIRECTV and EchoStar Bear the Burden of Demonstrating That the Proposed Merger Would Produce Efficiencies

20. Professor Willig incorrectly suggests that the merger opponents bear the burden of estimating the size of merger-related efficiencies. Citing my initial declaration, he states: “Opponents of this merger have not disputed [the assertion that the merged firm’s programming costs would be lower], but only dispute whether the size of these savings would be large enough

16. *Id.* at 27 ¶ 39 (“For example, if I assume for simplicity that New EchoStar engages in differentiated products Bertrand price competition with cable and other MVPD providers in K geographic markets . . .”).

17. Professor Willig suggests that larger markets would receive a greater weight because EchoStar is experiencing faster growth in those markets. *Id.* at 29, ¶ 42. However, this assessment ignores the effect of local broadcast service offerings on growth. If smaller markets were to receive local broadcast service, then those markets might grow faster than the larger markets, and hence they would receive a greater weight in EchoStar’s pricing formulation.

to outweigh any risk of a price increase after this merger. However, these opponents *have not attempted to quantify* the size of these cost savings.”¹⁹ It is not the job of the merger opponents to do so. Professor Willig has it backwards: with respect to claims of post-merger efficiencies, the merging parties—not the opponents or the government—bear the burden of proof.²⁰ Indeed, when the proposed merger generates a high market share in a given geographic area, the merging parties bear the burden “to produce evidence that ‘show[s] that the market-share statistics [give] an inaccurate account of the [merger’s] probable effects on competition’ in the relevant market.”²¹ DIRECTV and EchoStar fail to carry that burden in this case by their proffer of Professor Willig’s two declarations. For instance, although Professor Willig claims that the DBS companies have many programming contracts with volume discount clauses, he does not in any way “attempt to quantify” the size of those discounts and the extent to which marginal costs would decline.

18. Declaration of Robert D. Willig on behalf of AT&T Corp., in Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services, CC Dkt. 01-337 at 20, ¶ 35 (filed Feb. 28, 2002).

19. *Willig Reply Declaration*, *supra* note 3, ¶ 19 (emphasis added) (citing *Sidak Declaration*, *supra* note 1, ¶¶ 92-94).

20. *See, e.g.*, *FTC v. University Health, Inc.*, 938 F.2d 1206, 1223 (11th Cir. 1991) (“a defendant who seeks to overcome a presumption that a proposed acquisition would substantially lessen competition must demonstrate that the intended acquisition would result in significant economies and that these economies ultimately would benefit competition, and hence, consumers”). *See also* Department of Justice and Federal Trade Commission, 1992 Horizontal Merger Guidelines (Apr. 2, 1992) at § 0.1 n.5 (“[T]he burden with respect to efficiency and failure continues to reside with the proponents of the merger.”); Department of Justice and Federal Trade Commission, 1997 Horizontal Merger Guidelines (Apr. 8, 1997) at § 4.0 (“Therefore, the merging firms must substantiate efficiency claims so that the Agency can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so), how each would enhance the merged firm’s ability and incentive to compete, and why each would be merger-specific.”).

21. *FTC v. H.J. Heinz, Co.*, 246 F.3d 708, 720 (D.C. Cir. 2001) (quoting *United States v. Baker Hughes Inc.*, 908 F.2d 981, 982-83 (D.C. Cir. 1990)).

21. In August 2001, EchoStar offered to pay an 18 percent premium over Hughes's then-current stock price for DIRECTV.²² Based on its original offer price, the premium amounted to an expected increase in profits of \$4.9 billion (equal to \$32 billion less \$32 billion divided by 1.18). In my initial declaration, I estimated that the wealth transfer from DBS consumers to the merged firm ranged from \$300 million (under Cournot competition) to \$600 million per year (under perfect collusion),²³ which translates into a present discounted value that ranges from \$2.0 to \$4.0 billion over the next ten years.²⁴ Stated differently, I estimate that between two-fifths and four-fifths of EchoStar's expected increase in profitability is attributable to an expectation of increased market power. Given that potentially more than half of the premium can be explained by an expectation of increased market power, there is little chance that an efficiency defense can prevail.

1. Professor Willig Fails to Quantify The Claim of Programming Savings

22. Professor Willig claims that, as a result of the proposed merger, New EchoStar's programming costs would decrease due to volume discounts. That may or may not be true, as I discuss below, but most significantly, Professor Willig fails for a second time to quantify those alleged cost savings in any fashion or to substantiate his claim in any way. The repeated failure to provide verifiable evidence of programming cost savings, when the burden is clearly placed

22. Nikhil Deogun & Andy Pasztor, *EchoStar Plans to Launch \$32 Billion Bid for Hughes*, WALL ST. J. EUR., Aug. 6, 2001, at 1 (EchoStar offered 0.75 of its shares for each share of Hughes, which amounted to a valuation of Hughes at \$22.83 per share).

23. *Sidak Declaration*, *supra* note 1, at Table 3.

24. There is a growing literature that examines the relationship between the acquisition premium and market power. *See, e.g.*, Allan J. Cox & Jonathan Portes, *Mergers in Regulated Industries: The Uses and Abuses of Event Studies*, 14 J. REG. ECON. 1 (1998) (using event-study analysis to evaluate the merger of SBC Communication and Pacific Telesis); Serdar Dalkir & Frederick R. Warren-Boulton, *Reading the Leaves, Spreading the News: Event-Probability Studies of Mergers in (De-) Regulated Industries*, Working Paper (Apr. 2001) (analyzing the stock price movements of competitors of WorldCom and Sprint to gauge the competitive effect of a merger).

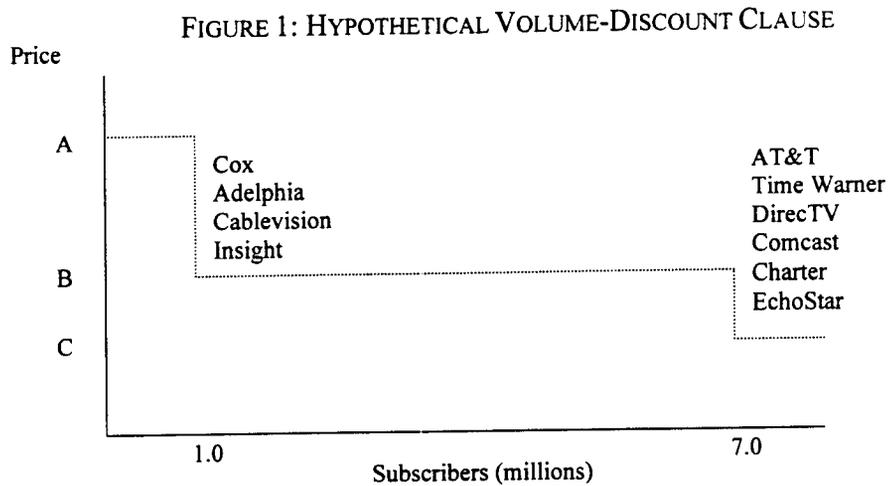
on the merger applicants to do so, should cause the Commission to disregard this claim of alleged cost savings.

23. Further, Professor Willig's attempt to characterize efficiencies related to programming costs as "merger-specific" does not follow from the facts that he cites. He claims that "this efficiency is merger-specific because neither DBS firm would be able to achieve such programming cost savings on its own."²⁵ To illustrate his claims of merger-specificity, Professor Willig states that certain programming contracts entitle EchoStar or DIRECTV to the same prices as those received by MVPD providers with similar subscriber bases. Professor Willig fails to mention that, as of the end of 2001, DIRECTV and EchoStar already had the third and sixth largest MVPD subscriber bases, respectively.²⁶ In addition, a 1999 article by Professors Tasneem Chifty and Christopher Snyder documents empirically that cable operators that integrated

25. *Willig Reply Declaration, supra* note 3, ¶ 20.

26. Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, Eighth Annual Report, CS Docket No. 01-129, 17 F.C.C.R. at Table C-3 (2002) [hereinafter *Eighth Annual Report*]. At the end of 2001, AT&T had 17.0 million cable subscribers. AT&T Corp., *Group Earnings Commentary, Quarterly Update - Fourth Quarter 2001* (released Jan. 30, 2002) at 12 (downloaded from <http://www.att.com/ir/pdf/014q_cmnt.pdf> on Apr. 16, 2002). Time Warner had 16.1 million cable subscribers. Information downloaded from <http://www.aoltimewarner.com/companies/time_warner_cable_index.adp> on Apr. 16, 2002. DIRECTV had 10.7 million subscribers. Information downloaded from <<http://www.directv.com/DTVAPP/aboutus/Investor.jsp>> on Apr. 16, 2002. Comcast had 8.4 million cable subscribers. Comcast Corp., *Comcast to Debut HDTV in Major Markets By End of 2002*, Company Press Release, Mar. 14, 2002 (downloaded from <http://www.comcast.com/press_room/default.asp?subsection=pr_cable_news#2002> on Apr. 16, 2002). Charter Communications had 7 million subscribers. Charter Communications, Inc., *Charter 2001 Pro Forma Cable Modem and Digital Customers Increase Nearly 165% and 82%, Respectively*, Company Press Release, Feb. 11, 2002 (downloaded from <<http://www.onlinepressroom.net/chrtr/>> on Apr. 16, 2002). EchoStar had 6.8 million subscribers at the end of 2001, and 7 million subscribers (as many as Charter) by Feb. 2002. EchoStar Communications Corp., *EchoStar Reports Record Fourth Quarter Revenue, EBITDA*, Company Press Release, Feb. 28, 2002 (downloaded from <http://www.corporate-ir.net/ireye/ir_site.zhtml?ticker=dish&script=410&layout=6&item_id=263854> on Apr. 16, 2002). Cox had 6.2 million subscribers. Information downloaded from <<http://www.cox.com/Corp/>> on Apr. 16, 2002. Adelphia had 5.5 million subscribers. Information downloaded from <<http://www.adelphia.com/about.cfm>> on Apr. 16, 2002.

horizontally did not enhance their bargaining position vis-à-vis video programming suppliers.²⁷ Unless the DBS companies provide the Commission with the language from particular contracts with programmers, it is impossible to know whether New EchoStar would experience any cost savings. Figure 1 presents a hypothetical volume-discount package that would not generate any savings for New EchoStar.



Source: Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, Eighth Annual Report, CS Dkt. No. 01-129, 17 F.C.C.R. at Table C-3 (2002); EchoStar Communications Corp., *EchoStar Reports Record Fourth Quarter Revenue, EBITDA*; *EchoStar's DISH Network Satellite TV Service Reaches 7 Million Customer Milestone*, Press Release, Feb. 28, 2002.

Figure 1 shows three hypothetical volume discounts for distributors of multichannel video programming: (1) distributors with fewer than one million subscribers pay \$A; (2) distributors with more than one million but fewer than seven million subscribers pay \$B; and (3) distributors

27. Tasneem Chipty & Christopher M. Snyder, *The Role of Firm Size in Bilateral Bargaining: A Study of the Cable Television Industry*, 81 REV. ECON. & STAT. 326 (1999) ("Thus, our estimates of the supplier's surplus function call into question the popular claim that the prevalence of horizontal integration among cable operators is motivated by bargaining effects.").

with more than seven million subscribers pay \$C. Under this hypothetical volume-discount clause, the proposed merger of DIRECTV and EchoStar would not generate any savings for New EchoStar.

24. Even if certain volume discounts were set above the DBS companies' current level of subscribers, internal growth would increasingly allow both DBS companies separately to take advantage of the volume-discount clauses that Professor Willig describes. DIRECTV and EchoStar have been the fastest growing firms in the MVPD industry. In an April 2002 SEC Form 8-K filing, DIRECTV announced that its sales had exceeded projections for the first quarter, and that it had added 342,000 net subscribers.²⁸ EchoStar has grown from 5.26 million subscribers at the beginning of 2001 to 7 million in February 2002, a growth rate of 33 percent in 14 months.²⁹ Indeed, the number of DBS subscribers is increasing at roughly 18 times the rate of increase in the number of cable subscribers.³⁰ Given this rate of growth, which far outstrips cable, the DBS carriers should be able to increasingly take advantage of whatever volume discounts in the purchase of video programming are available.

2. Professor Willig Presents No Evidence that the Offer of Local Services in All 210 DMAs Would Be a Merger-Specific Efficiency

25. In his initial Declaration, Professor Willig stated that the proposed merger would allow New EchoStar to provide services to 100 or more communities as compared to 40 now.³¹ In his reply declaration, however, he now states that the proposed merger would allow service to

28. HUGHES ELECTRONICS, 2002 FORM 8-K (Apr. 15, 2000); Subscriber total downloaded from <<http://www.directv.com/DTVAPP/aboutus/Investor.jsp>> on Apr. 17, 2002.

29. EchoStar Communications Corp., *EchoStar Reports Record Fourth Quarter Revenue, EBITDA*, Company Press Release, Feb. 28, 2002 (downloaded from <http://www.corporate-ir.net/ireye/ir_site.zhtml?ticker=dish&script=410&layout=6&item_id=263854> on Apr. 16, 2002).

30. NATIONAL CABLE AND TELECOMMUNICATIONS ASS'N, *COMPETITION IN THE VIDEO MARKETPLACE IS HERE TO STAY 2-3* (Jan. 2002) (downloaded from <http://www.ncta.com/pdf_files/Competition.pdf> on Apr. 16, 2002).

all 210 DMAs, but that neither company could serve all 210 DMAs on its own because of additional costs and the necessity to forgo alternative services.³² He also states that, although DIRECTV separately will have the technical capacity to offer local service to 103 DMAs, cost factors will limit it to 70 or fewer DMAs.

26. Professor Willig has no independent basis for these assertions and offers no evidence from the DBS firms to support them. To be credible, such statements would need to be backed by an analysis that would include a quantification of the private costs and benefits from adding a DMA. Professor Willig provides no data on any of these points, except for an estimate that DIRECTV would have to launch a new satellite for \$220 to \$300 million to serve all 210 DMAs.³³

27. Nor does Professor Willig present evidence that this alleged benefit is merger-specific. Neither Professor Willig nor I are held forth as experts on engineering matters, so our opinions on technical matters are uninformative. However, it is worth noting that Professor Willig's conclusions are based on a static-state analysis. He assumes that there will be no further innovation leading to greater satellite capacity. Such an analysis does not comport with the experience of the DBS industry. Indeed, in the span of only a few weeks, EchoStar and DIRECTV were able to increase from 100 to 210 the number of DMAs that they believed they could serve economically if allowed to merge. This change in outlook by the two DBS firms raises the question of how many markets each firm might serve individually absent the proposed merger. EchoStar and DIRECTV have presented no evidence on this point, which makes it

31. *Willig Reply Declaration*, *supra* note 3, ¶ 24.

32. *Id.* ¶¶ 14-15.

33. *Id.* at ¶ 15.

impossible to assess to what extent their offer to serve all 210 DMAs is a merger-specific efficiency.

28. An additional reason to question whether this proffered efficiency is not achievable but for the proposed merger is the possibility that service to all 210 DMAs could be achieved through a production joint venture that would achieve the desired spectrum efficiencies without eliminating competition between the two DBS providers. The fact that the EchoStar and DIRECTV now propose to offer service to all 210 DMAs after the proposed merger suggests that they might find it economically rational to do so even without the proposed merger.

3. The Welfare Gains Associated with the Introduction of Additional Services May Be Insubstantial

29. Professor Willig's quest for additional merger-specific efficiencies leads him to posit a series of possible benefits, ranging from more specialized programming to a variety of enhanced services. A central problem with his recitation is that it entails no attempt to specify the value of such services to consumers. It is not clear that the value to consumers would be great.

For instance, Professor Willig states:

The spectrum efficiencies and expanded channel capacity resulting from the merger will allow New EchoStar to expand specialized programming offerings. Such programming could include ethnic, foreign language, educational, or other programs that appeal to specific audiences.³⁴

Professor Willig does not mention that, as of April 2002, DIRECTV and EchoStar offered 250 national programs, including over 50 ethnic programs, foreign-language programs, and educational programs.³⁵ For the purpose of merger analysis, the relevant consumer benefit is not the consumer benefit from *all* ethnic, foreign-language, and educational programs. Rather, it is

34. *Id.* ¶ 22.

the *incremental* consumer surplus that would be created by the next ethnic station, the next foreign-language station, or the next educational program. The concept of satiation is well recognized in the economic theory of consumer behavior.³⁶ Because DIRECTV currently offers 45 Spanish-language stations alone on its *DIRECTV Para Todos* package,³⁷ the incremental consumer surplus created by the next Spanish-language station, however large, would not likely compensate Hispanic DBS consumers for their welfare losses associated with higher DBS prices.

30. Furthermore, Professor Willig's assertion that the proposed merger would allow for investment in the creation of additional channels ignores the economic theory of fixed costs. A fixed-cost reduction is equivalent to a rich uncle—it is a *non-merger-specific* source of funding for the merged firm. Professor Willig does not explain why the fixed-cost reduction would be used to add channels, rather than being paid to shareholders as a dividend. Regardless of its source of the funding, a DBS firm will produce the next foreign-language channel *only* if it promises a return on investment that exceeds the firm's cost of capital.³⁸

31. The other efficiencies that Professor Willig asserts would flow from the proposed merger are equally unsubstantiated. According to Professor Willig, the proposed merger would lower the fixed costs of the merged firm, thereby increasing the likelihood that new advanced services would be deployed. He suggests that this highly uncertain event, if it were ever realized, would bring enormous benefits to consumers: "Since *it appears* that consumers value the new

35. Information downloaded from EchoStar's web site at www.dishnetwork.com and DIRECTV's website at www.DIRECTV.com on Mar. 13, 2002.

36. See, e.g., HAL R. VARIAN, MICROECONOMIC ANALYSIS 98 (W.W. Norton 3d ed. 1992) (discussing diminishing marginal utility of consumption).

37. Information downloaded from http://www.DIRECTV.com/DTVAPP/learn/FAQ_DTVProgramming_Languages.jsp on Apr. 1, 2002.

services that New EchoStar will be able to offer once the spectrum duplication is eliminated, the consumer surplus gains from the increased availability of advanced services could potentially be quite substantial.”³⁹ Professor Willig provides no evidence that (1) the proposed merger would lower fixed costs, (2) that the smaller fixed costs would facilitate the introduction of new services, and (3) that consumers would value the new services (let alone by how much). Professor Willig calls his own claim into severe doubt when, in the very next paragraph of his declaration, he acknowledges the low valuation that customers have placed on past “advanced” DBS service offerings:

EchoStar and Hughes currently offer satellite-based Internet access products, but consumer acceptance of these products has so far been limited Despite the fact that satellite-based Internet access is technically available in all areas of the United States, the low penetration rate of this technology—even in areas without any access to DSL or cable modem service—raises questions about whether households in both rural and urban areas are likely to accept it on a large scale.⁴⁰

Given Professor Willig’s own analysis of consumer ambivalence toward satellite-based Internet access services, it is difficult to understand his basis for claiming that customers would value new advanced services supposedly made possible by a reduction in fixed costs owing to the proposed merger.

32. Consumers might value these “merger-specific” efficiencies modestly. For example, Professor Willig puts forward video-on-demand service as one example of an advanced service that would be provided if the proposed merger were approved. Existing DBS subscribers can already choose from over 100 stations of recent movie releases beginning every half-hour.

38. More precisely, each DBS provider likely ranks projects according to their internal rate of return, and chooses those with the highest rankings. For a discussion of internal rates of return, see RICHARD A. BREALEY & STEWART C. MYERS, *PRINCIPLES OF CORPORATE FINANCE* 48 (McGraw-Hill 5th ed. 1996).

39. *Willig Reply Declaration*, *supra* note 3, ¶ 28 (emphasis added).

40. *Id.* ¶ 29.

The industry refers to this feature as “virtual” video on demand. Hence, to estimate the *incremental* consumer surplus of actual video-on-demand service, one would need to estimate the value associated with a consumer’s saving on average fifteen minutes per downloaded movie.⁴¹ Professor Willig presents no evidence that this savings would outweigh the consumer welfare losses that the proposed merger would inflict through higher DBS prices (and higher cable television prices).

33. In summary, Professor Willig pins the approval of the proposed merger on the premise that the unknown and unsubstantiated consumer welfare gains associated with additional programming and unproven, “advanced” services will outweigh the consumer welfare losses associated with the higher prices for (proven) DBS services. This proposition fails the Merger Guidelines requirement that cognizable efficiencies be verified, rather than “vague or speculative,” a requirement of particular force when applied to a proposed merger to monopoly or near-monopoly, as here.⁴²

II. THE NATIONAL PRICING PLAN IS NOT A VIABLE SAFEGUARD

34. The Commission cannot rely upon Professor Willig’s analysis of EchoStar’s promise to charge a uniform national price after the proposed merger. There is no assurance that the merged DBS firm would not discriminate against rural customers. Even if the merged DBS

41. In March 2002, DIRECTV subscribers could watch *Pearl Harbor* for \$3.95 beginning every halfhour. Information downloaded from DIRECTV’s web site at www.DIRECTV.com on Mar. 13, 2002. If *Pearl Harbor* were available instantaneously through video-on-demand service, then the average subscriber who wanted to rent *Pearl Harbor* would decrease his wait time by fifteen minutes. Professor Willig might argue that the value of video-on-demand service is more than the instantaneous availability of recently released movies. But if DIRECTV were to make *all* movies available instantaneously, then the value of any subscription service like HBO would fall to zero. Clearly, such an outcome would not be in DIRECTV’s interest.

firm did not discriminate against rural customers, DBS consumers in urban areas would face higher prices after the proposed merger.

A. The Commission Cannot Rely Upon Professor Willig's Analysis Because There Is No Assurance that the Merged DBS Firm Would Not Discriminate Against Rural Customers

35. For uniform pricing to protect rural DBS customers from higher prices, Professor Willig assumes that the merged firm would honor its pledge to price in a nondiscriminatory fashion. Because EchoStar insists on flexibility in the implementation of uniform pricing, and because the merged firm could break its pledge in subtle ways, the Commission cannot rely upon Professor Willig's analysis.

1. EchoStar Would Reserve the Right to React to Local Promotions by Cable Television Operators

36. Professor Willig's analysis ignores EchoStar's announcement in December 2001 that, under a uniform national pricing plan, the firm would still reserve the right to react to local promotions by cable television system operators. Mr. Charles Ergen, EchoStar's chief executive officer, has attempted to respond to concern about cable television systems' "cherry-picking" by saying that the merged DBS firm would not *really* implement a uniform national pricing plan. Instead, EchoStar would retain the ability to respond to price promotions and equipment rebates offered by cable television system operators in specific local markets: "if somebody comes in and offers a \$300 rebate to get your customers in a particular location, then you have to have the

42. Department of Justice and Federal Communications Commission Horizontal Merger Guidelines 1997, at § 4 (Apr. 8, 1997).

ability to respond to that.”⁴³ But Mr. Ergen’s insistence on retaining the ability to charge different prices in different local markets would, of course, eviscerate the “uniform” pricing plan.

37. Professor Willig repeatedly asserts that a uniform national pricing plan would “export” the competition from “more competitive DMAs,”⁴⁴ thereby allowing the benefits of competition with cable television systems to trickle down to customers in rural areas who are not offered cable television service. Professor Willig’s analysis is inconsistent with Mr. Ergen’s comment about his need for local pricing flexibility to respond to the competitive actions of cable television system operators. Indeed, it is difficult to understand how competition would be “exported” from urban to rural markets if, within the framework of a “uniform” and “national” pricing plan, the merged DBS firm retained the prerogative to respond to competitive pressures in specific geographic markets.

2. Because of the Multiple Ways That DBS Firms Compete on Price and Non-Price Dimensions, a Uniform National Pricing Plan Would Be Impossible to Enforce

38. Even under a uniform national pricing plan, there are at least four ways in which the merged DBS firm could discriminate against customers without access to cable television service. First, the merged DBS firm could vary the price of equipment or installation, or both. Second, the merged firm could offer rebates to customers who mail in their cable television bills. Third, the merged firm could reduce the number of channels available to customers in areas without cable television service. Fourth, the merged DBS firm could vary the price of local channels.

43. *Ergen Makes His Case*, SATELLITE BUS. NEWS, Dec. 31, 2001, at 1 (quoting Charles Ergen) [hereinafter *Ergen’s Statement*].

44. *Willig Reply Declaration*, *supra* note 3, ¶¶ 6, 34, 35, 38, 90, 107.

a. The Merged DBS Firm Could Vary the Price of Equipment or Installation, or Both

39. In response to my demonstration that the merged DBS firm could discriminate across geographic markets by varying the price of equipment and installation at the local level, Professor Willig argues that competition between local retailers and national retailers (like Circuit City and Best Buy) would protect consumers in areas without cable television service.⁴⁵ Professor Willig suggests that rural customers who live too far to drive to a national retailer could “take advantage of direct sales from New EchoStar, or could purchase their equipment over the Internet.”⁴⁶ As of April 1, 2002, neither DIRECTV nor EchoStar made equipment purchases available over the Internet. Each firm requires the customer to contact a retailer in his local area. Moreover, because installation is a service and not a product, it would be impossible for the merged DBS firm to make installation available over the Internet.

40. Professor Willig also states that the existence of national retail chains that carry DBS set-top boxes would prevent the merged DBS firm from engaging in geographic discrimination: “Equipment is sold either directly by the DBS firms on a national basis, by local or regional retailers, or, in most cases, by large, national retail chains that also set a national price. These chains are present in so many areas that consumers, regardless of whether they have cable as an option, will be able to take advantage of the national offers.”⁴⁷ Professor Willig incorrectly takes national chain stores’ continued carriage of DBS set-top boxes as a given under a monopoly DBS provider when the current widespread carriage of DBS set-top boxes *results*

45. *Id.* ¶ 103.

46. *Id.*

47. *Id.* ¶ 89.

from the current competition between DIRECTV and EchoStar.⁴⁸ Competition between DIRECTV and EchoStar induces each firm to pay commissions to national retailers in exchange for carrying that firm's set-top box. If DIRECTV and EchoStar did not compete with one another, there would be no reason for them each to offer a premium to the national chain for exclusivity. Mr. Ergen's stated interest in substantially reducing the commissions earned by national chains could prompt those same national chains to stop carrying DBS systems.⁴⁹ In contrast to Professor Willig's vision of DBS distribution after the proposed merger, consumers likely would not be able to take advantage of national DBS promotions through national retail chains.

b. The Merged Firm Could Offer Rebates to Customers Who Mail in Their Cable Bills

41. Professor Willig suggests that it is too difficult for EchoStar and DIRECTV to assess whether a customer has access to cable television service, and that the cost of erring—charging the higher DBS price to a customer who really has access to cable television service—is prohibitive.⁵⁰ To demonstrate how difficult detection is, Professor Willig cites a study by a Washington D.C.-based research firm, which identified twenty zip codes that are characterized by Warren Communications' database of local cable television systems as not having access to cable television service but are allegedly wired for cable television. Professor Willig's critique of the Warren data is flawed for at least two reasons.

48. See, e.g., David Lieberman, *Combining Systems Could Inconvenience Consumers*, USA TODAY, Oct. 30, 2001 (questioning whether "chains such as Best Buy, Circuit City, Radio Shack or Blockbuster will have much incentive to promote EchoStar's service, which will use the DIRECTV brand").

49. *Ergen's Statement*, *supra* note 43.

50. *Willig Reply Declaration*, *supra* note 3, ¶ 102.

42. First, the Warren data present census block groups—not zip codes—that are wired for cable television. Because a zip code is larger than a census block group, it is possible that certain census blocks contained within the twenty zip codes do not have access to cable television service while other census blocks within the same zip codes do have access. The fact that there are individuals with access to cable television service in the same zip code that contains a census block that the Warren data indicates to be unpassed by cable is not sufficient to demonstrate that the Warren data are flawed.

43. Second, Professor Willig does not disclose how many Warren zip codes the research firm tested. For example, if the research firm tested 200 zip codes, and if it found that Warren was wrong on twenty occasions (10 percent of the time), then the inference that one would make on the reliability of the Warren data would be different from the inference that one would make if the research firm tested 20,000 zip codes (errors occurring 0.1 percent of the time). Professor Willig does not supply that critical information.

44. Finally, it is reasonable to believe that a company with the resources of EchoStar or DIRECTV could detect, with a reasonable degree of accuracy, whether its customers have access to cable television service. For example, the DBS firm could simply ask the customer whether he or she had access to cable television service before the sale of DBS service. More likely, each DBS firm has developed over the years a thorough database of geographic areas with and without access to cable television service. In fact, DIRECTV recently informed the FCC that 29 percent of its customers did not have access to cable service.⁵¹

⁵¹ Comments of DirecTV, Inc., Annual Assessment of the Status of Competition in the Markets for the Delivery of Video Programming, CS Dkt. No.01-129 (filed Aug. 3, 2001).

45. Setting aside the questionable issue of detection, a very simple means by which the merged DBS firm could discriminate against customers without access to cable television service would be to offer rebates to customers who mail in their cable television bills. Under this discriminatory scheme, customers without access to cable television service would be forced to pay the higher (standard) price, while customers with access to cable television service would be entitled to the discount. Indeed, both DIRECTV and EchoStar have implemented such pricing schemes in the past.⁵²

c. The Merged Firm Could Reduce the Number of Channels for Customers in Areas without Cable Television Service

46. As another strategy of geographic discrimination, the merged DBS firm could use spot beams to target certain national channels exclusively at larger DMAs. That is, the merged DBS firm could withhold select national content from smaller DMAs. The merged DBS firm could claim that certain channels fare much better with urban market demographics, and it could then broadcast those channels exclusively to non-rural residents. If the merged DBS firm were required to carry the same number of channels in all areas, it could target more expensive channels at non-rural DMAs and cheaper “filler” stations to rural DMAs—all ostensibly in the name of better serving the consumer. Although the merged DBS firm would continue to charge a single national price for its programming packages, the quality of (and cost per subscriber for) the packages could vary on a local basis.

52. On February 23, 1998, DIRECTV launched an advertising campaign urging cable customers to switch to DIRECTV. See *DIRECTV Capitalizes on Cable Complaints*, ADVERTISING AGE, Feb. 23, 1998, at *1. Shortly thereafter, EchoStar offered free programming to cable customers who turned in their cable bills. See *Dish Network Announces Unbeatable Deal*, BUS. WIRE, Mar. 11, 1998.

47. One way of differentiating between urban and rural markets is suggested by DIRECTV's current course of conduct with YES, the new New York Yankee network. YES is available as part of DIRECTV's Total Choices® monthly service to customers in and around New York City, but it is available elsewhere only to subscribers to the DIRECTV SPORTS PACK, a completely different package, with its own pricing.⁵³

48. Alternatively, the merged DBS firm could adopt a plan of continuously "test marketing" new channels in the larger DMAs. For example, the merged DBS firm could offer a new sports channel free-of-charge to select DMAs for a limited time. Then, upon expiration of the trial period, the firm could immediately offer a new movie channel to the same DMAs for a limited period of time. By targeting those new offerings at DMAs in which the monopoly DBS provider faced particular competitive challenges from cable television system operators, the merged firm could effectively respond to local MVPD competition by augmenting the value of its service in only those areas. A uniform national pricing plan would not force the merged firm to respond to local competition at the national level. The DBS monopoly would by no means be forced to "export" the benefits of urban competition to rural consumers.

d. The Merged DBS Firm Could Vary the Price of Local Broadcast Channels

49. Because local broadcast channels are offered only in their originating DMAs, they are not a part of the national DBS programming package. Hence, the merged DBS firm could satisfy a uniform national pricing pledge simply by charging a single national price for each *non-local* programming package. The merged DBS firm would, however, be free to charge different

⁵³ DIRECTV, *YES Network and DIRECTV Announce Network's First Distribution Agreement*, Company Press Release, Feb. 5, 2002 (downloaded from

prices for different local broadcast packages. For example, the merged firm could charge \$3.99 per month for local broadcast channels in Los Angeles, California, and \$5.99 per month for local broadcast channels in Billings, Montana. Local broadcast channel offerings differ considerably from region to region, so the merged DBS firm could claim that such varied prices merely reflect the differing demand characteristics (and costs) of each local service package. In the absence of cost-based regulation of DBS prices, which no one is proposing that the FCC impose, there would be no way to confirm that the price-cost ratio for local broadcast programming was the same across all geographic markets in which the merged DBS firm offered local broadcast channels.

B. Even If the Merged DBS Firm Did Not Discriminate Against Rural Customers, DBS Consumers in Urban Areas Would Face Higher Prices

50. A uniform national pricing plan would be anticompetitive. It would raise DBS prices for all urban customers and would facilitate collusion between the cable television system operator and the remaining DBS firm. Professor Willig does not remove the basis for either concern.

1. The Post-Merger Uniform Price Would Exceed the Pre-Merger Discriminatory Price in Areas with Cable Television Service and Would Likely Exceed the Pre-Merger Discriminatory Price in Areas without Cable Television Service

51. Professor Willig argues that monopoly rural markets would be protected after the proposed merger by a uniform national price, which he claims would be most affected by conditions in more populous urban markets, where most potential customers reside. However, Professor Willig does not dispute that the post-merger nationwide price would exceed the pre-

<http://www.directv.com/DTVAPP/aboutus/headline.jsp?id=02_05_2002A> on Apr. 16, 2002).

merger price in urban areas. There are two reasons for this outcome. First, in urban areas the proposed merger would reduce the number of competitors from 3 to 2, making an already concentrated market into an extremely concentrated market, with a strong likelihood that prices would be higher than the pre-merger level. Second, a post-merger uniform national price that is lower than the unconstrained rural price must be supported by prices higher than the unconstrained price in urban areas that would obtain under a regime of differential pricing. Instead of confronting that issue, Professor Willig conjectures that the post-merger price in rural areas would be the same as the post-merger price in urban areas:

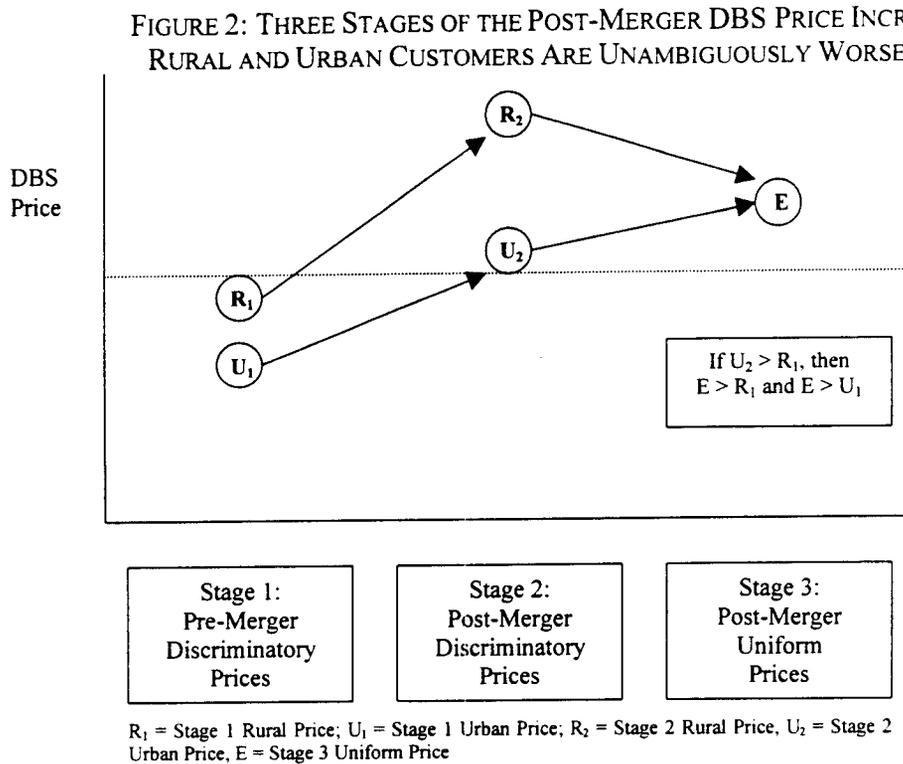
As noted above, larger DMAs appear to be more competitive than smaller DMAs. For example, larger DMAs are more likely to have digital cable systems which are a more formidable competitor to DBS, since they eliminate DBS' quality and channel capacity advantages. Therefore, New EchoStar's national price will allow smaller, more rural DMAs to benefit from the more intense competition in larger DMAs.⁵⁴

Professor Willig fails to answer my demonstration that, after the proposed merger, urban customers would face higher DBS prices (and a greater price increase than that to be expected simply from the reduction in the number of competitors from 3 to 2).

52. As I explained in greater detail in my initial declaration,⁵⁵ to set the uniform national price, the profit-maximizing DBS firm would raise the duopoly price to the point where the gains from rural consumers (gains from inframarginal consumers minus losses from marginal consumers) would equal the losses from urban consumers (gains from inframarginal consumers minus losses from marginal consumers). The resulting uniform price would be lower than the discriminatory post-merger rural monopoly price and higher than the post-merger discriminatory urban duopoly price. Because the uniform price would be imposed under *less* competition in the

54. *Willig Reply Declaration*, *supra* note 3, ¶ 46.

two representative geographic markets, it is easier to analyze the effect of the uniform pricing pledge by disaggregating the price increase into three stages. Figure 2 shows how the merged firm would choose a uniform post-merger DBS price beginning from discriminatory pre-merger prices.



As Figure 2 shows, the post-merger discriminatory prices in both rural and urban areas are higher than the respective pre-merger discriminatory prices (R_2 is greater than R_1 and U_2 is greater than U_1). Indeed, the price increase in rural areas is greater (the line R_1 - R_2 is steeper than the line U_1 - U_2) because demand for DBS service in rural areas is less price elastic. The post-merger uniform price is a weighted average of the post-merger discriminatory prices in areas with and without cable television service. As Figure 2 shows, if the post-merger price in urban areas exceeds the

55. *Sidak Declaration*, *supra* note 1, at 31 ¶¶ 54-56.

pre-merger price in rural areas—that is, if U_2 is greater than R_1 —then one can infer *unambiguously* that both rural and urban customers of DBS service are worse off under the post-merger uniform national price.⁵⁶

2. The National Price Would Facilitate Collusion with Cable Television System Operators

53. Professor Willig believes that the nature of competition between the DBS carriers and cable television system operators will remain unchanged if the proposed merger is approved:

The proposed merger between DIRECTV and EchoStar . . . will eliminate spectrum redundancies and allow for expanded channel capacity—which will likely spur the development of new programming and new innovative services. Such an expansion of channel capacity will likely force cable systems to continue to upgrade their network infrastructure. Relative to today's cable infrastructure, an upgraded cable system will exert even more competitive pressure on DBS pricing—thus perpetuating the virtuous cycle of competitive innovation.⁵⁷

Professor Willig is incorrect. Cable television operators have upgraded their systems *in response to* the serious challenges posed by DIRECTV and EchoStar. If that competition were undermined by industry consolidation, then cable television operators would be relieved from the competitive pressure to innovate. Professor Willig fails to note that elimination of the second DBS firm would likely induce exit by suppliers of innovative content and next-generation set-top boxes, which would harm the “virtuous cycle of competitive innovation” that he extols. The proposed merger would make the competition between the merged DBS firm and cable television operators less robust.

56. The only scenario where the change in welfare for rural customers of DBS services is ambiguous is if the post-merger discriminatory price in urban areas is less than the pre-merger discriminatory price in rural areas. Under such a scenario, it is impossible to say with certainty on the basis of a priori reasoning whether the uniform pricing pledge will restore the welfare of rural customers. The question is an empirical one for which EchoStar and DirecTV bear the burden of proof. Nonetheless, the change in welfare for urban customers under a post-merger uniform pricing regime is adverse under *any* scenario. Professor Willig has yet to dispute my demonstration that, even if the merged DBS firm were to abide by its pledge to price in a nondiscriminatory manner, DBS customers in urban areas would pay higher prices.

54. Moreover, Professor Willig too quickly dismisses the likelihood that the merged DBS firm would coordinate prices with the local cable television operator:

Although New EchoStar will face competition from at least one cable firm in any particular franchise area, tacitly reaching an agreement on a coordinated price is not simply a question of reaching an agreement with one other firm. New EchoStar will set its price based on a function of what cable firms are charging in the various franchise areas. From the perspective of the cable firms, the optimal price for New EchoStar to charge would likely differ from firm to firm, making an agreement all the more difficult to reach.⁵⁸

Professor Willig ignores that a handful of cable television multiple systems operators (MSOs) now control a significant majority of all cable properties. As of June 2001, the top four MSOs—AT&T-Comcast (assuming that the proposed merger is approved), AOLTime Warner, Charter, and Cox—served 70 percent of all cable television customers.⁵⁹ Hence, price coordination between AT&T, for example, and the merged DBS firm could occur in the hundreds of local cable television systems controlled by AT&T. Contrary to Professor Willig's assertions, the merged DBS firm would *not* need to reach hundreds of distinct arrangements with each local cable television system operator owned by AT&T, AOL-Time Warner, Comcast, and the other large MSOs.

CONCLUSION

55. Professor Willig has failed to produce any relevant analysis to rebut the presumption of anticompetitive effects that is made in the case of a merger to monopoly or near monopoly, much less answer the arguments as to anticompetitive effects made in my initial declaration. Moreover, Professor Willig has failed to document the merger-specific efficiencies

57. *Willig Reply Declaration*, *supra* note 3, ¶ 49.

58. *Id.* ¶ 72.

that he claims would flow from this merger-to-monopoly. Professor Willig's two declarations in this proceeding do not contain the evidence that would be necessary for EchoStar and DIRECTV to carry their burden of proof on either issue. Professor Willig supplies no information of probative value to support his assertion that the merged DBS firm could lower its programming cost by taking advantage of volume discounts. Nor does he supply any evidence to support the claim that the unknown incremental consumer surplus associated with additional programming or enhanced services would compensate for the enormous consumer welfare losses that my initial declaration and Professor MacAvoy's initial declaration demonstrated would result from higher DBS prices following the proposed merger. Professor Willig's reply declaration does not alter the conclusion that the Commission can protect consumer welfare in this proceeding only by rejecting the proposed merger of DIRECTV and EchoStar.

* * *

I declare under penalty of perjury that this declaration is true and correct. Executed this 24th day of April, 2002.


J. Gregory Sidak

59. *Eighth Annual Report*, *supra* note 26, at Table C-3.