More Thoughts on the Road to Monopoly

It has been six months since that now famous weekend in late October over which General Motors Corp. and Hughes Electronics Corp. shocked virtually everyone and signed an agreement to sell Hughes and its DirecTV unit to Charlie Ergen’s EchoStar Communications Corp. Instead of Rupert Murdoch’s News Corp.

Since then, much has been said and written about whether combining EchoStar and DirecTV into the nation’s only mainstream DBS service would be good for competition, and thus for American TV consumers. The political and public relations battle has drawn an enormous amount of attention, and is now one of the most visible such fights in Washington — where EchoStar, Hughes, and their opponents have hired a small legion of lobbyists, lawyers, and others to do their bidding.

In these pages in the week following the EchoStar-Hughes announcement, the propriety of this space argued that the marriage of the nation’s only two DBS services would create a satellite TV monopoly that would represent the single biggest setback to competition in the video marketplace in the past 20 years, and lead to significantly higher prices for satellite and cable consumers in the immediate future. Nothing EchoStar and Hughes, or anyone else, has said or done over the past 180 days has changed that view one iota.

That consumers in rural areas, who would be losing the ability to choose between EchoStar and DirecTV, and thus have only one option for multichannel TV, would be protected by a so-called national pricing plan that would have them paying the same subscription prices as urban and suburban customers.

That the creation of this satellite TV giant is the only way that satellite TV will be able to sell local TV stations via satellite to dish owners in rural TV markets.

That the combined EchoStar-Hughes will be the only company in a position to offer two-way Internet services via satellite.

In short, since EchoStar and Hughes have found some argument to counter the most obvious result if their merger is approved — the creation of a DBS monopoly and a dramatic reduction in competition — they have settled on marketplace blackmail: All the things that will never happen if they are not allowed to become a monopoly. It is the "gun to the head" approach, particularly when one of EchoStar and Hughes’ other tactics is figured in. Almost since the deal was announced, the companies have launched a quiet whispering campaign in Washington that basically says DirecTV will die if it is not absorbed by EchoStar, or, worse yet, Murdoch may gain control of DirecTV if the Hughes-EchoStar deal is blocked. They have tried to make Murdoch the villain, to not only foster antagonism against Murdoch, who is not well liked in some quarters, but to eliminate Murdoch as someone who can pick up the pieces if the deal is blocked.

That said, a point-by-point examination of the EchoStar-Hughes political talking points follows:

- Perhaps the biggest falacy advanced by EchoStar and Hughes is the idea that neither DirecTV or EchoStar have provided much competition to cable as separate entities, are strong companies by themselves, and need to merge to battle cable.

That could be further from the truth. Could they possibly contradict both companies’ repeated statements over the years?

Were EchoStar and Hughes portraying an accurate picture on this point, both would have had to have made repeated false statements to the Securities and Exchange Commission (SEC), the courts, and Congress over the years time and time again. Along the same lines, Hughes lawyers, in particular, have completely misrepresented the now 6-year and often hostile fight between DirecTV and EchoStar in the marketplace. Even Wall Street analysts, not the most discerning or knowledgeable lot, had to laugh holding their own against cable.

Just ask anyone in the cable business.

Just look back at the number of times EchoStar and DirecTV launched "bounty" programs to steal each other’s satellite subscribers, and paid retailers hundreds of dollars to convert a DBS customer to their service.

Then there are the companies’ own abundant statements. Both companies’ attorneys have often tried to downplay how inquiries to the companies’ anti-trust lawsuits against DirecTV. They have basically argued that what is filed by lawyers in a federal lawsuit should not be taken all that seriously, that attorneys are advocates for their companies. But statements made by both in the lawsuit are so forceful, so clear cut, and so specific that would not both companies be guilty of some level of perjury if the statements they have made about the lawsuit in the past six months are true?

In a filing in the antitrust case less than nine months before announcing its bid for DirecTV, EchoStar wrote that, “DirecTV and EchoStar react primarily to each other when setting equipment and service prices.” Again, that statement was made, under penalty of sanctions or worse. In a federal court filing less than nine months before EchoStar announced a formal bid for Hughes.

DirecTV and Hughes told the court much the same, saying in an earlier filing of their own that they “admit that...”

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According to SEC filings, the new company will be prevented from selling additional stock to its investors for at least two years after the merger would close, and will be limited to returning to the debt market. That will make it very difficult for EchoStar to raise substantial amounts, because it will have to entice investors into buying notes of a company already carrying a mountain of debt and piling on more to raise money.

This is one of the most fundamental ingredients to factor into any appraisal of the EchoStar-Hughes deal. In the post-Enron era, companies that already have large debt loads, particularly those with modest market cap values, are going to face increasing scrutiny in capital markets which are already tight. The fact that DirecTV recently had to restate its subscriber numbers from years past is going to make it even more difficult for EchoStar to raise capital through debt financing.

Even accepting EchoStar’s estimates on what it will cost to convert existing customers to new satellites, build new satellites, pay for the transition, and rollover new services, it will need to spend $5 billion to $7 billion. That is the “promise price tag,” by EchoStar’s own accounting.

Most industry hands say that EchoStar is significantly low-balling those costs, which they put in the $10 billion to $12 billion range. And the cost of the transition is likely increasing by the day. A satellite receiver that could be billion to $3 billion in estimated 2005 synergies by the companies trumpeted when they announced their agreement. The use of the word “estimate” aside, that claim gives “smoke and mirrors” a whole new meaning. So much so, that even those inside the companies think the amount of savings through so-called “synergies” will ever materialize. Interesting enough, the companies have mostly stopped talking about “synergies” in recent weeks.

The cost of the conversion is likely one of the reasons that DirecTV has so far refused to agree that its transmission and conditional access systems should be scrapped in favor of EchoStar’s. DirecTV’s 10.56 million subscribers, and some 15 million receiving sets (counting secondary sets, commercial establishments, and the like) will be far too expensive to trade out. There is now some thought that DirecTV may lease non-DirecTV boxes, such as some of which are Wink-enabled, will not have to be changed because their software can be upgraded over the satellite. That is only a small fraction of DirecTV’s customers.

EchoStar, on the other hand, can upgrade almost all of its 7.2 million homes, and 10 million boxes, via satellite, though each would require a new security card.

Problems, there is universal agreement that EchoStar’s transmission technology, and its conditional access/security system, are superior to DirecTV’s. While EchoStar’s system is compromised, and has suffered some real setbacks in the last three years, it is far more robust than DirecTV’s. Even more importantly, EchoStar has all but made clear that it will fight tooth and nail to keep its technologies. Some contend EchoStar will never agree to change out its subscribers to DirecTV’s system or ever agree to use DirecTV’s conditional access/security system, which was developed by a Murdoch-controlled company.

Most hackers say they would prefer DirecTV’s conditional access system to live
on forever, but opinion is divided over whether it would be easier for hackers if they had only one system to focus their attacks on versus two.

Money aside, most agree with EchoStar's view. Because DirecTV has control over what features are included in receivers for its service, hardware manufacturers such as Thomson Consumer Electronics Inc. and others have been prevented from incorporating many new features in DirecTV receivers. As a result, EchoStar's boxes have leapfrogged DirecTV's in many aspects.

And under almost any scenario mentioned by EchoStar and DirecTV, almost all of both firm's subscribers would need some new equipment and/or service call to re-point or replace their dishes.

So again, the question is whether EchoStar will be able to pay for a conversion without at some point trying to get consumers to pay all or part of the bill? EchoStar has repeatedly said it will keep the costs of the conversion down by allowing customers to "upgrade" boxes to get new features and acquire new capabilities. How many times will EchoStar try to "sell" new equipment, making all kinds of promises, to consumers before it actually gives consumers a free conversion? And given EchoStar's past, what it will call a "conversion" versus an equipment "upgrade"—which it will charge customers for—will make Bill Clinton's famous line, "It depends on what the meaning of the word 'is' is" look credible.

Many of the same financial realities will also prevent EchoStar from fulfilling one of its other ballyhooed claims, that it will be the only company able to deliver two-way satellite Internet services. That pledge has been at the heart of EchoStar's wooing of rural areas and the lawmakers who represent rural communities. EchoStar and Hughes have struggled, but in the case of Starband and WildBlue, corporate politics, much of which was engineered by EchoStar—which owns a stake in both—were the main reasons for the difficulties.

Uncumbered by debt and distractions, is trying to do just that, and as he said a few months ago, if there is a market for a two-way satellite data services, there will be many companies eager to invest the capital to develop them.

In fact, due to the financial and operational burdens that will challenge the new EchoStar, it could be argued that EchoStar may be in the worst position to try and roll out a new generation of Ka-band two-way Internet satellite services.

The matter of how rural America will be impacted by a potential EchoStar-DirecTV combination has been among the hottest topics of debate in recent months.

Any view is, rural Americans will lose. Big time.

Above all else, the elimination of competition resulting from having only one choice for satellite TV will hurt rural consumers more than any others. Not only are many rural Americans without a cable TV option at all, but those with cable TV are often the oldest, most antiquated systems with the fewest channels.

Yet again EchoStar's own words in a filing in the antitrust suit sums it up best: "Millions of potential DBS customers also live in areas that do not have access to cable," EchoStar wrote. "For these millions of customers and potential customers, if there is no competition between [DirecTV] and [EchoStar], there is no competition at all.

To counter this, EchoStar says it will not charge rural consumers any more for programming than subscribers in other areas under a self-declared "national pricing" plan. That sounds good, but few believe it is remotely workable.

EchoStar itself has cast a sole goal of balting EchoStar to react. If EchoStar bites, it probably would, the cable operator will immediately claim that EchoStar is violating its own national pricing pledge.

Indeed, were there only one cable operator in each market competing with the service, these types of promotion squabbles would likely be the only fleeting competition there is. Imagine that. Price promotion and competition would be giving way to political price fixing. The minute the political rhetoric died down, the promotions would head for the hills and the lower prices vanished into the heavens.

After unprecedented opposition from rural lawmakers surfaced in the months after the Oct. 29 merger announcement, EchoStar and Hughes realized they were losing the political battle, and the rural question was among the main reasons why. Since having only one from fulfilling or multichannel video service in rural America is not a great selling point for any potential deal, the DBS firms made what at the time was widely viewed to be a very shrewd political hail-mary. During a Feb. 26 press event they announced that if they were allowed to consolidate, they would begin the process of distributing local TV stations in every place in the nation some two years after the merger closed.

At the time, the murkiness of the timeline offered aside, many thought the announcements would quell much of the rural opposition and as a result greatly improve the companies' chances.

For the most part, that has not happened. For the most part, the announcement has produced very little political benefit for EchoStar and Hughes.

Many thought the idea made no economic sense to begin with. According to Nielsen Media, the top 100 TV markets in the nation account for some 80 percent of all U.S. television homes.

Since it is now clear that EchoStar and DirecTV could each serve those 100 markets with local stations where the merger was not approved, one of the main justifications for merging into a monopoly is providing local TV stations via satellite to about 14 percent of American TV homes.

While few asserted that the combined EchoStar and Hughes should be dismissed or ignored, many also argued that it would be unfair for 86 percent of American homes to be forced to pay significantly higher prices so that 14 percent have the availability of local TV stations via satellite.

And consumers in all parts of the nation would pay higher prices. The lack of competition would not only lead to skyrocketing prices, but the success of the venture would make it easier for the cost to provide local stations in the rural markets for limited subscriber revenue would only make it worse. The equation is simple: it costs the same amount to uplink a TV station to a satellite for reception in Gendive, Montana, the country's 210th and smallest TV market as it does to uplink a TV station for viewing in New York, the nation's biggest TV market.

There are 7.3 million TV homes in the New York market for satellite TV services to market to, according to Nielsen.

In Gendive, Nielsen statistics indicate, there are 3,900 TV households.

The fundamental financial formula of operating satellites and fundamental economic realities dictate that the viewer in New York will have to help pay for those in Gendive. And Americans in both places, in all markets.
will end up with much higher bills. There is no escaping that.

National pricing, even if it came to pass, does not mean low pricing.

Once again, it must be emphasized that no one favors shortchanging rural America. But a far better way must be found to help defray the costs of providing local channels via satellite, and other new services, to rural homes than EchoStar and Hughes have proposed. Many other companies have to be part of the solution, many other ideas have to be explored. It will not be an easy task, but it is the most feasible for a company operating under an immense pile of debt, devoting billions of dollars and taxing its human resources trying to turn two large and complicated companies into one.

For these reasons, the EchoStar and Hughes promises of national pricing, local stations for all, as well as almost everything else the companies say they will deliver, are nothing more than that: promises. And at best, they are political promises, the most fleeting and unenforceable.

Simply stated, EchoStar will become an unregulated, and, more importantly, un-enchanted monopoly if the government blesses its acquisition of Hughes and DirecTV.

The reasons of why invariably lead to, and set the stage for, a discussion about whether the Department of Justice could craft a consent decree to protect consumers from abuse by the EchoStar monopoly.

EchoStar has publicly said it would agree to a consent decree covering the so-called national pricing and all local channel vows it had made. So what?

What would happen if, and when, EchoStar fails to live up to both? Or any of the other things it has committed to?

For all practical purposes, nothing.

The Justice Department, as a matter of general practice, is loath to enter into consent decrees that require it to either have an ongoing role in seeing that a company is actually doing what it agreed to or one that requires a company to spend money to build something.

It almost always prefers what are known as structural remedies, which involve one-time moves by a company, such as the divestiture of certain assets or facilities, that allow it to find that a merger would not hurt the public interest.

"Any way the numbers are crunched on this deal, any way the math is done, any way the industry or local market is defined, allowing EchoStar and DirecTV to become one will dramatically reduce the ‘viable choices’ for every American TV consumer.”

In this case, there are only two such remedies that anyone can think of, and they have no chance of being accepted by EchoStar. Many have proposed that EchoStar be forced to sell one of the full-DISH DBS orbital slots it would own after the deal closes, the only such slots over America.

EchoStar has already indicated that it is the proverbial non-starter. And in this case, it is easy to see why. Spending $2 billion in 2002 to buy DirecTV in this full-DISH satellite, or justifying any other such satellite, or it as turns out, its technical calculations were incorrect? Or even if someone succeeds in gaining control and decides to "break up" EchoStar. That would make the break up of the old AT&T look good.

If EchoStar manages to put this Humpty-Dumpty together, it is never ever going to be broken apart. The logistics and cost would be overwhelming and astronomical.

The Importance of having two DBS services cannot be overstated. Cable operators, of course, do not compete with each other, even though six or seven cable companies will soon almost all have cable subscribers, that does not change the number of multichannel choices available to most consumers. And after squandering billions of dollars over the past 15 years, telephone companies and would-be cable overbuilders would be left with closed up shop or had virtually no impact on the market. The idea that there could be a second wire-line/cable video distribution channel to the home on a large scale basis has been

Community Chest

“EchoStar will be transformed into the first unregulated, untrustworthy government-sanctioned monopoly.”

Scott-Free

Thus, in almost all ways, EchoStar would have the government over a barrel. When someone owes a bank $10 million, the bank "owns" that person. When a person owes a bank $10 billion, that person "owns" the bank.

EchoStar will be transformed into the first unregulated, untrustworthy government-sanctioned monopoly.

The Justice Department’s Antitrust Division is now run by a very smart lawyer in

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charge will creep up every year.

If the EchoStar-DirecTV deal closes, a $6 billion tag for basic packaging of programming—with no movie channels, sports, or other additions, will become the national average in a couple of years. And it will go up from there.

At that point, consumers can also forget about paying new programming services, especially niche or specialized channels. If there are only two video distributors in each local market, and practically none of the cable companies still have limited channel capacity, EchoStar will become the bottleneck of bottlenecks. It will be able to extract any term if it wants from any potential new service. As a result, such start-ups will have to pay EchoStar for distribution, or give up equity to EchoStar, or otherwise agree to whatever EchoStar wants. The barriers to entry for any new channel will be especially severe, especially for a service that is trying to introduce a new concept to the market and is not a spin-off of an existing service.

There is no better example of why having that third choice is essential than the recent spat between the new YES regional sports network and the cable companies. In the New York area and Cablevision, that region's dominant cable operator, and the equally nasty but now settled dispute between Disney/ABC and EchoStar over carriage of two of Disney's cable channels.

In most places in the New York area at this moment, the only way to watch the YES Network and the New York Yankees is through DirecTV. EchoStar and Cablevision have not agreed to terms with the channel. Imagine if there was only one cable operator and one satellite service? Both could easily hold our collective channel without fear. The "third choice," whatever, in this case. It is DirecTV, EchoStar, or Cablevision is the "wild card" that affords consumers a modicum of protection against being victim to distributors who would become gatekeepers with more raw market power than ever before.

Some may argue that dynamic could help keep programming prices down. That will never happen. The two distributors will not only be able to dictate terms to programmers, but they will have so much clout that they will be in a position to exercise control over content. As far as prices go, when only a handful of companies such as YES and the aforementioned small group of cable operators and EchoStar—have unchallenged market control, the ceiling on what they will charge will keep going up.

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pronounced all but dead. And anyone who believes the Internet will become a mass video distribution channel in the next 20 years should just "pass go" and move right to selling aluminum siding or hot tubs.

In reality, the two video options that exist today—satellite and cable—will be the only two for the foreseeable future. Thus, the number of DBS services will be the sole factor in determining how many alternatives consumers will have to their cable system. EchoStar or DirecTV, as Individual companies, are the only "third choices."

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"There is a better chance that the actual Rock of Gibraltar will fly over the United States than that SES' plan will fly. The whole idea has to get the 'SkyPix Award' so far for 2002. Maybe it should be called, 'The Crook of Gibraltar.'"

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and more dynamic leadership could make the transition into running the nation's only DBS service. The monopoly EchoStar would control the only three full-COMBS DBS orbital slots. Thus, in addition to ruling on the public interest and competitive aspects of this proposed transaction, state and federal officials are also obliged to judge whether EchoStar would be the best custodian of that immense chunk of spectrum and able to live up the public trust obligation.

"But maybe, just maybe, this deal affords government officials a rare opportunity to simultaneously satisfy their political agendas and act in the best interest of American consumers, to prevent the formation of an unregulated, untouchable government monopoly that will, without any doubt, result in far higher prices for satellite and cable subscribers in the near future."