

a 94% share of the aggregate nationwide MVPD market.¹¹ See DirectTV Comments at 14, 18. Of course, in local franchise areas, which constitute the relevant geographic market, the cable share may be even higher. As the Commission found in its 1994 Cable Report, "most local markets for multichannel video programming distribution services are supplied by monopoly cable systems." 1994 Cable Report, 9 FCC Rcd. at 7556; see also DOJ Comments at 2. The Department of Justice agrees that "the MVPD market today is effectively a series of local monopolies controlled by cable television companies." DOJ Comments at 2. See also NPRM ¶ 36.

2. DBS Operators Will Not Compete Vigorously Against Their Cable Affiliates

An outright prohibition on cable entry into DBS is further justified by the certainty that cable-affiliated DBS providers will not vigorously compete against their own cable operator affiliates. Support for this proposition can be found in the public statements of Dr. John Malone, President of TCI, who has unequivocally confirmed that he does not see "much of a logic" in a transition from cable to satellite reception for

¹¹ The largest cable operators (TCI and Time Warner, both PRIMESTAR Partners) have further solidified their dominance in the market by increasing their share of all cable subscribers to 19.50% and 14.51%, respectively. See DirectTV Comments at 14.

cable-served homes, and that therefore the big market opportunity for PRIMESTAR is in the uncabled areas, not in the cabled areas.^{8/} Despite the protestations of TCI and PRIMESTAR to the contrary, see Tempo Comments at 12, PRIMESTAR Comments at 18, the Commission can and should reasonably conclude on the basis of Dr. Malone's authoritative statements that, at least, TCI-affiliated DBS operators, including PRIMESTAR, will continue to target uncabled areas and thus will not compete at all, let alone vigorously, against affiliated cable operators.

Dr. Malone's statements are consistent with the findings of the Department of Justice. In its comments, the Department explains that independent DBS providers can be expected to offer products and set prices in ways that will maximize their profits in the DBS business, whereas cable-affiliated DBS providers will likely offer DBS products and prices that will maximize their aggregate profits in both DBS and cable, thereby having "less incentive to offer DBS service that competes against cable." DOJ Comments at 5-6. These observations pinpoint the fundamental flaws in Tempo's and PRIMESTAR's contention that cable-affiliated DBS operators can be expected to compete vigorously in the DBS market because

^{8/} See August 21, 1995 letter from counsel for EchoStar to Scott Blake Harris and attachment, Appendix 2 hereto.

otherwise they would be ceding market share to a DBS competitor. See Tempo Comments at 12; PRIMESTAR Comments at 21. First, they are flatly contradicted by Dr. Malone's public assessment of the market. Second, the aggregate revenues reaped through the large cable operators' local monopolies are far greater than the revenues that PRIMESTAR can be expected to generate from satellite distribution. Therefore, large cable operators can rationally be expected to compromise revenues or profits from DBS to protect their local franchises.^{2/}

In deciding to restrict cable entry into DBS, the Commission need only rely on the market power of cable operators and the fact that they will not compete vigorously against themselves, thus tending to perpetuate their local monopolies. The Commission need not make any findings about specific forms of anti-competitive behavior in which cable operators may or will engage. Nevertheless, EchoStar and Directsat note that a plethora of types of anti-competitive conduct are available to

^{2/} EchoStar and Directsat also resubmit for the record of this proceeding the Declaration of Roger G. Noll, one of the most distinguished economists in the country, filed on December 16, 1994 in Advanced Communications Corporation, File No. DBS-94-15ACP. (Appendix 3 thereto). In that Declaration, Professor Noll demonstrates that the acquisition by TCI's subsidiary of 24 full-CONUS channels would have profound anti-competitive effects, both horizontal and vertical. The Commission can and should rely on Professor Noll's expert opinion in promulgating structural safeguards as well as conduct restrictions.

large vertically-intergrated cable operators and are also consistent with their incentives to maximize revenues. For example, a cable-affiliated DBS operator could engage in predatory pricing in rural areas to prevent DBS providers, such as EchoStar and Directsat, from attaining critical subscriber mass in those areas to be competitive in urban markets. Tempo's contention that predation is impossible is clearly wrong.^{10/}

Cable operators could also add PRIMESTAR subscribers to their cable subscriber base for the purpose of invoking non-existent economies of scale and thus justifying programming price differentials that substantially raise their unaffiliated rivals' costs.^{11/} Alternatively, cable-affiliated programmers

^{10/} Tempo asserts that "[a]n operator simply could not price below its cost for the long period required to drive out of the market competitors with significant sunk costs, but very low variable costs." Tempo Comments at 13. Yet if a DBS provider were only able to cover its variable costs, its inability to contribute toward its capital costs would certainly drive it out of business. Tempo also remarkably contends that "the lack of barriers to entry into the MVPD market now and in the future make recoupment of lost profits through supracompetitive pricing impossible." Id. The barriers to entry into the MVPD market are quite steep. For example, entry into the DBS business requires investments in the hundreds of millions of dollars with substantial competition and market risks. This is precisely why there currently is a lack of effective competition in the MVPD market. If entry barriers were low, competition would have flourished by now.

^{11/} EchoStar and Directsat agree with DirectTV that the Commission should prohibit this practice, even though such prohibition would only be a partial remedy. See DirectTV Comments at 19.

could use an affiliated DBS provider as a "Trojan horse" to set an artificial floor (or "benchmark") on the programming rates payable by any satellite operator. By charging independent DBS operators the same rates as they charge their cable-affiliated DBS operator, cable-affiliated programmers can argue that they do not discriminate against independent MVPDs and thus comply with the program access rules, even though the rates available to affiliated cable operators are significantly lower.^{12/} These examples certainly do not exhaust the gamut of anti-competitive conduct available to cable operators and their DBS and programming affiliates.

3. The Cincinnati Bell Case Is Distinguishable Because There Is Factual Support For Cross-Ownership Restrictions In The Record

Tempo invokes the Sixth Circuit's recent decision in Cincinnati Bell Tel. Co. v. FCC, Nos. 94-3701/94-4113, 95-3023/95-3238/95-3315, 1995 U.S. App. LEXIS 31585 (6th Cir. Nov. 9, 1995), in support of the proposition that a cable/DBS

^{12/} As discussed below, such a method for evading the program access rules cannot be fully tackled by a prohibition on cable acquisition of DBS channels, so long as PRIMESTAR continues to operate from a Ku-band FSS satellite. The Commission should thus also clarify that cable-affiliated programmers bear the burden of proving that a price differential as between cable operators and DBS providers is justified by cost differences or economies of scale.

cross-ownership ban would be arbitrary. That case is clearly distinguishable in light of the substantial record in this proceeding supporting a Commission conclusion that a cross-ownership ban is appropriate for cable/DBS affiliates. As detailed above, a cross-ownership ban here is warranted because of:

- the market power of cable operators in the MVPD market as established by the voluminous record collected by the Commission in its annual MVPD inquiry;
- the assertion of Dr. Malone that cable-affiliated DBS providers do not plan to compete against cable operators; and
- the expert analysis by the Department of Justice regarding cable-affiliated DBS providers' incentives to maximize profits from their affiliated businesses.

None of these facts apparently was established in the Personal Communications Service ("PCS") rulemaking proceeding that was on review in Cincinnati Bell. There, the Commission had confined itself to assertions that cellular providers "might engage in anticompetitive behavior or exert undue market power through, for example, predatory pricing schemes." Id. at *27. In fact, the market power of large cable operators in the MVPD market, which is a necessary predicate of a cross-ownership restriction here, is substantiated and beyond dispute. Each

local cable franchise is typically characterized by the near-monopoly (a market share of more than 90%) enjoyed by a single cable operator, whereas each cellular licensing area has service from two cellular licensees in addition to any other wireless providers. In addition, in the PCS proceeding there was no evidence that cellular-affiliated PCS providers would not compete against their cellular affiliates. Had there been such evidence -- in the form, for example, of a statement by a cellular licensee comparable to Dr. Malone's public comments -- in conjunction with evidence of near-monopoly domination of the relevant market, the court would doubtless have upheld the reasonable imposition of a cross-ownership restriction.

Based on the undeniable market power of cable operators and its expert assessment of the marketplace, the Department of Justice concluded that large cable operators should not be allowed to acquire DBS channel assignments unless they divest themselves of a large part of their cable assets. The Commission is entitled to rely on the Department's analysis and should adopt its recommendations.^{13/} At a bare minimum, the

^{13/} A failure by the Commission to adopt the Department of Justice's recommendations would lead to the following anomaly: the Commission would allow a cable affiliate to acquire DBS assignments in an auction, while the Department of Justice would likely seek an injunction against a cable affiliate seeking to acquire control over the same number of assignments in a private merger or other similar transaction.

Commission should adopt the 16-channel spectrum cap on dominant MVPDs suggested by EchoStar and Directsat in their Comments.

B. The Commission Should Not Impose Spectrum Or Location Caps On Non-Dominant MVPDs

As previously shown, there is abundant factual support for restricting access to the DBS spectrum resources by dominant MVPDs and their affiliates. On the other hand, there is no reason whatsoever to attempt to dictate the structure of the DBS sub-market by imposing spectrum or location caps on non-dominant MVPDs. There is simply no evidence in the record for the Commission to hold a priori that a non-dominant MVPD provider would in all cases become dominant in any market by acquiring more than 32 channels or by acquiring channels at more than one orbital location. Instead, the Commission can and should conduct a case-by-case review of such transactions to determine whether they are in the public interest.

Tempo, joined by other cable commenters, argues that, "[i]f the FCC nonetheless subjects cable-affiliated DBS operators to an orbital slot (or spectrum aggregation) limit ... competitive equity dictates that the same restrictions be applied to unaffiliated firms." Tempo Comments at 9; PRIMESTAR Comments at 23. Tempo simply misses the point. The reason why large

cable operators should be restricted from access to DBS channel assignments is their overwhelming market power in the MVPD market. For multi-channel distributors that lack market power, there are no economic reasons for imposing similar restrictions, and the imposition of such restrictions despite a lack of market power would be arbitrary. It is specious of Tempo to request the imposition of indiscriminate restrictions on all DBS providers in the name of "competitive equity." Regrettably, competitive equity in the MVPD market does not exist because of the near-monopoly power of cable operators. Rather than creating any inequity, the imposition of restrictions on dominant MVPDs would be a step toward leveling the playing field by encouraging independent competition in the MVPD market.^{14/}

III. THE STRENGTHENING AND CLARIFICATION OF THE COMMISSION'S PROGRAM ACCESS RULES ARE CRITICAL TO THE SUCCESS OF DBS

In their Comments, EchoStar and Directsat have demonstrated that, to effectuate the 1992 Cable Act's prohibition on unfair practices, the Commission should expand and clarify its current program access rules. Because anti-competitive conduct by cable operators and programmers in this area directly affects

^{14/} On the other hand, the restrictions on acquisition of DBS channels should apply not only to cable operators but to all MVPDs that may be subsequently found by the Commission to be dominant, whether they are large cable operators or not.

the cost of programming to independent DBS providers, which is in turn the single most significant operating cost for such providers, the effective elimination of all unfair practices prohibited by the Act is critical to the successful emergence of DBS as an effective alternative to cable.

In particular, EchoStar and Directsat have recommended that: (1) the prohibition on discriminatory pricing of programming should apply to all programmers, whether affiliated with a cable operator or not, since discrimination can result from the exercise of monopsony power by the cable operators as much as from vertical integration; and (2) programmers should squarely and without exception bear the burden of proving that programming price differentials as between cable operators and DBS providers are justified by cost savings or economies of scale. Typically, the costs incurred by a programming vendor in a transaction with a cable operator are greater than in a transaction with a satellite distributor, and it is therefore reasonable to require the vendor to prove a deviation from the norm. An express clarification by the Commission that the burden of proof on such issues lies with programming vendors, and its consistent enforcement of that burden allocation, will help prevent vendors from invoking cost differentials or savings that do not exist.

A. The Current Program Access Rules Are Insufficient To Curb Anti-Competitive Behavior By Cable Operators

Tempo predictably argues that the program access rules are sufficient to prevent DBS-related unfair practices by cable operators. Tempo Comments at 22. Yet, as discussed in detail in EchoStar's and Directsat's Comments, these rules do not adequately address many of the anti-competitive practices employed against DBS providers.

Thus, the Commission has already noted the potential regulatory vacuum arising because its program access rules are limited to programming supplied by vertically integrated programming vendors (even though the statutory prohibition on unfair practices is not so limited). In the 1994 Cable Report, the Commission noted the possibility, suggested by several commenters, that "cable operators, using their buying power over programmers, can extract concessions from non-vertically integrated programmers that raise rival operator's costs of obtaining programming or deny them access to programming altogether." 1994 Cable Report, 9 FCC Rcd. at 7552. See BellSouth Comments at 8-9; American Satellite Network Comments at 6. The Commission further observed that "[t]o a certain extent, the potential for such conduct may have been limited by the Commission's recent decision amending its program carriage (as

distinguished from the program access) rules." 1994 Cable Report, 9 FCC Rcd. at 7552 (citation omitted). By the referenced amendment, the Commission gave MVPDs standing to file a complaint alleging that a cable operator has coerced a vendor, whether affiliated or not, into an exclusivity agreement, thus denying access to the MVPD.^{15/} However, while this provision may help curb the use of a cable operator's monopsony power to deny a competing MVPD access to programming, it does not prevent use of such power to achieve discriminatory terms and raise a rival's costs. In particular, the program carriage rules do not appear to give an MVPD standing to allege discrimination by a vendor as a result of a cable operator's market power. To that extent, the problems noted by the Commission in the 1994 Cable Report remain, and the Commission should amend its access rules specifically to prohibit such cable-engineered discrimination whether or not the programming vendor is vertically integrated, consistent with the Cable Act's broad prohibition on unfair practices by cable operators.

EchoStar and Directsat further note that, under the complaint procedures prescribed by the Commission, an allegation

^{15/} See In the Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992 Development of Competition and Diversity in Video Programming Distribution and Carriage, MM Docket No. 92-265, Memorandum Opinion and Order, 9 FCC Rcd. 4415, 4419 (1994).

by a programming vendor that a price differential is justified by cost differences or economies of scale must be part of that vendor's answer or affirmative defenses. See MM Docket No. 92-265, First Report and Order, 8 FCC Rcd. 3359, 3417 (rel. Apr. 30, 1993). To that extent, the Commission should clarify that the burden of proving such economies and cost differentials lies on the defendant-vendor.

The Commission's procedures, however, also allow the defendant vendor to state its belief that the complaining MVPD and the cable operator in question are not "sufficiently similar, and thus cannot be realistically compared." Id. Upon stating the reasons for this belief, the vendor may submit "an alternative contract for comparison with another more similarly situated MVPD that uses the same distribution technology as the competitor selected by the complainant." Id. (footnote omitted).

This procedural opportunity afforded programming vendors is inconsistent with the appropriate allocation of the burden of proof. It essentially allows a vendor to compare its contract with the complainant DBS provider with another DBS contract (rather than with a contract with a cable operator). This, in turn, allows the vendor to get away with "benchmarking" -- uniformly high prices charged to DBS providers and uniformly

low prices charged to cable operators, as if the difference in the distribution technology accounts for lower costs and justifies lower prices for cable operators. Of course, the reverse is typically the case. As Mr. Ergen has explained in his Verified Statement attached to EchoStar's and Directsat's Comments, the cost of a transaction between a programming vendor and a cable operator is typically greater than the cost of a transaction between the same vendor and a DBS provider. Thus, this procedural exception can be used unfairly to exonerate the defendant vendor from what should be its burden of proof. The Commission should thus eliminate the opportunity of programming vendors to substitute a DBS contract for a cable contract as a measure of comparison.

B. The PRIMESTAR Consent Decrees Are Insufficient To Curb Unfair Practices And Should Not Deter The Commission From Imposing The Necessary Restrictions Especially On Cable Operators

In response to the Commission's inquiries in this area, the cable interests indignantly invoke the consent decrees that the PRIMESTAR Partners have entered into with the Department of Justice and with the State Attorneys General. In doing so, the cable interests appear to make two contradictory arguments. On the one hand, they argue that the restrictions contained in

the two PRIMESTAR consent decrees "adequately provide for a robust and competitive DBS environment," thus obviating the imposition of further restrictions by the Commission. See Tempo Comments at 3. On the other hand, they argue that the PRIMESTAR consent decrees have expiration dates and that therefore "conduct restrictions are not properly extended indefinitely into the future" by the Commission. Id. at 20. They conclude that the Commission should not impose conduct restrictions beyond the decrees' expiration dates. In other words, the cable interests argue that the Commission should not impose conduct restrictions both because the consent decrees exist and because they soon will expire.

First, the consent decrees themselves make clear, and the Commission has confirmed, that the decrees do not bind the Commission or preclude further regulation. As the Commission has noted, "[t]he PRIMESTAR Final Judgment specifically provides that the decrees do not preempt the 1992 Cable Act or the Commission's rules."^{16/}

^{16/} See In the Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992; Development of Competition and Diversity in Video Programming Distribution and Carriage, Memorandum Opinion and Order, MM Docket No. 92-265, 9 FCC Rcd. 3105, 3121 (rel. Dec. 23, 1994). In the context of assessing the lawfulness of exclusive contracts between DBS distributors and vertically-integrated satellite cable

(continued ...)

In any event, the PRIMESTAR consent decrees are, like the program access rules, insufficient to address the concerns expressed by EchoStar, Directsat and other DBS interests. Neither consent decree squarely prohibits discrimination against DBS providers by cable unaffiliated programming vendors as the result of the unilateral exercise of monopsony power by a cable operator. Similarly, neither consent decree creates a presumption that programming price differentials are not justified by cost savings or economies of scale. While the consent decrees do contain some helpful provisions, they do not go nearly far enough.

The Department of Justice also does not consider the consent decrees adequate to curb anticompetitive behavior; instead, it recommends the structural safeguard of foreclosing large cable operators from access to DBS channels. In this respect, EchoStar and Directsat note that adoption of the Department's recommendation by the Commission will still not address all of the vertical conduct problems identified herein.

^{16/} (... continued)

programming vendors, the Commission has specifically found that "the PRIMESTAR proceedings have no relevance to the disposition of the issue before us." Id. The Commission also cited to the Transcript of Hearing on Proposed Consent Decree, State of New York v. PRIMESTAR Partners, No. 93-3868, at 22-23 (S.D.N.Y. Sept. 3, 1993), where the presiding judge stated that "there is nothing in this decree that binds the FCC in any way" Id.

The Commission still must strengthen and clarify its program access rules effectively to address these concerns.

Nor can the expiration provisions of the consent decrees fairly be read to denote an intent by the Justice Department or the State Attorneys General to leave the conduct of the PRIMESTAR Partners forever unrestricted. Certainly, the Justice Department itself does not read the expiration provisions in this manner as reflected in its structural recommendations. Indeed, the expiration of the conduct restrictions embedded in the PRIMESTAR consent decrees, makes it all the more imperative for the Commission to exercise its authority and give effect to the statutory prohibition on unfair practices.

IV. THE COMMISSION MUST ENSURE A LEVEL PLAYING FIELD IN THE PROVISION OF WHOLESALE SATELLITE DISTRIBUTION

EchoStar and Directsat aspire to provide wholesale DBS services to cable systems and other terrestrial MVPDs.^{12/} They subscribe to the Justice Department's profound competitive

^{12/} Tempo accuses the Commission of misapprehending the meaning of HITS and mistaking it for the wholesale provision of programming. See Tempo Comments at 25; see also PRIMESTAR Comments at 31. EchoStar and Directsat understand HITS as a wholesale distribution service provided to other MVPDs, including the aggregating, digitizing, compressing and transmitting of video signals via satellite, and in this regard agree with both the Commission and the Justice Department. See DOJ Comments at 12.

concerns arising from the provision of wholesale DBS by an affiliate of downstream cable systems and upstream programming vendors. As the Department observes, terrestrial MVPDs "would probably favor the more established DBS providers as demonstrated by a substantial existing subscriber base in retail DBS and in affiliated MVPDs." DOJ Comments at 14. In addition, EchoStar and Directsat are concerned that terrestrial MVPDs will favor wholesale DBS provided by their own affiliates even if an independent DBS provider were able to offer the service more efficiently. In addition, EchoStar and Directsat fear that programmers may impose more onerous restrictions on their ability to provide wholesale DBS than on cable-affiliated providers.

To address these concerns, EchoStar and Directsat support the adoption of the rules recommended by Justice Department with the following additions to proposed rule (c):

(c) Add: No wholesale DBS provider shall coerce any programming vendor into discriminating and no programming vendor shall discriminate in the prices, terms and conditions of sale or delivery of programming between competing wholesale DBS providers where one such provider is affiliated with a cable operator.

No cable operator shall purchase DBS from a wholesale DBS provider on the basis of its affiliation with that provider or shall refuse to purchase DBS from a wholesale DBS provider on the basis of its non-affiliation with that provider.

V. CONCLUSION

For the foregoing reasons and those set forth in their Comments, EchoStar and Directsat respectfully request that the Commission adopt their recommendations.

Respectfully submitted,

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I, Pamela S. Strauss, hereby certify that a copy of the foregoing Reply Comments of EchoStar Satellite Corporation and Directsat Corporation was hand-delivered on this 30th day of November, 1995, to the following:

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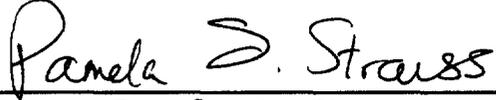
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August 21, 1995

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Re: Advanced Communications Corporation, File Nos.
DBS-94-11-EXT/15ACP/16MP

Dear Scott:

EchoStar Satellite Corporation ("EchoStar") hereby submits a taped excerpt and a corresponding transcript from a recent interview of Mr. John Malone, President of Tele-Communications, Inc. ("TCI"), which is the owner of TEMPO DBS, Inc. ("Tempo") and a partner in Primestar Partners, L.P. ("Primestar"), to Mr. Bob Scherman, editor and publisher of Satellite Business News. This interview confirms that, as EchoStar has argued all along in these proceedings, TCI does not intend to use the Direct Broadcast Satellite ("DBS") assignments of Advanced Communications Corporation ("Advanced") to compete against cable operators. In the interview Mr. Malone is told that 80% of current Primestar subscribers are outside cable areas, and is asked whether this ratio must change to make Primestar a profitable entity if Primestar moves to high-power DBS. Mr. Malone responds that, with the advent of digital cable systems, he does not believe "that there will be much of a logic for a transition from cable to satellite reception for cable