

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

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

In the Matter of)

Revision of Rules and Policies)
for the Direct Broadcast Satellite)
Service)

IB Docket No. 95-168

PP Docket No. 93-253

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REPLY COMMENTS OF ECHOSTAR SATELLITE CORPORATION
AND DIRECTSAT CORPORATION

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SUMMARY

EchoStar Satellite Corporation ("EchoStar") and Directsat Corporation ("Directsat") hereby submit these joint reply comments in the above-captioned rulemaking proceeding. Many of the comments filed in response to the Commission's Notice of Proposed Rulemaking ("NPRM") lend support to EchoStar's and Directsat's position that: an auction of the Advanced channels would impermissibly reopen the Continental processing round, and would emasculate the method already chosen by the Commission for resolving mutual exclusivity of these pending applications. The rights of EchoStar and Directsat to additional DBS channels would be nullified by such an auction, notwithstanding that each permittee has invested hundreds of millions of dollars in reliance on its rights under Continental.

Furthermore, the Commission lacks statutory authority to conduct the proposed auction of DBS channels because it has failed to consider adequately alternative methods for resolving mutual exclusivity; because such alternative methods are available (and indeed superior to auctions); and because an auction would fail to satisfy the statutory criteria for determining whether competitive bidding is appropriate in this case. The views expressed by several commenters serve to illuminate the Commission's lack of authority to auction these

DBS channels as well as the blatant inequities that such an auction would entail. Indeed, the support for the Commission's proposal expressed by DirectTV demonstrates beyond dispute that, far from accomplishing the statutory objectives of expedition, competition and efficiency, an auction would guarantee the longest delay in the use of the DBS channels at 110° W.L. In a recent statement to the press, the vice-chairman of Hughes Electronics (DirectTV's parent) has explained that Hughes supports auctions here, despite its general opposition to auctions, precisely because it would delay the emergence of competition.

Many commenters also remind the Commission that competitive bidding is inappropriate for satellite services, including DBS. While some parties ask the Commission to find that an auction is only appropriate in the "unique" circumstances of this case, in fact, the circumstances of this case are indistinguishable from those of other satellite services. Thus, an auction would invite similar action by other governments, making international service by U.S. licensees prohibitively expensive and frustrating the immense public benefits from such service. In addition, an auction would handicap U.S. licensees by requiring them to pay hundreds of millions of dollars for the same right that non-U.S. licensed foreign entities will continue to exercise free of charge.

With respect to the competitive issues, EchoStar and Directsat unequivocally support the position taken by the Department of Justice -- that large cable operators should be prohibited from accessing any DBS spectrum unless they divest themselves of their cable assets. The Commission should give considerable weight to the Department's expert views that allowing cable to control DBS resources would tend to perpetuate the existing market power of large cable operators and retard the development of DBS as an effective competitor to cable television. Even if the Commission were to reject the Department's well-reasoned recommendations, it should, at a minimum, impose on dominant-affiliated MVPDs a 16-channel cap as suggested by EchoStar and Directsat.

On the other hand, there is no reason at all to impose spectrum caps on non-dominant MVPDs like EchoStar and Directsat, which lack the market power to engage in anti-competitive behavior. This does not mean that the Commission should allow a non-dominant MVPD to become dominant by acquiring additional DBS channels. Rather, the Commission should review the acquisitions of additional capacity by non-dominant MVPDs on a case-by-case basis, and prohibit such transactions where appropriate to protect against the likelihood of market-dominant behavior. Nor should a dominant non-cable MVPD be exempt from structural

restrictions. These same restrictions should apply to all dominant MVPDs, not just to cable operators as suggested by DirecTV.

With respect to non-discriminatory access to programming, which is vital to the emergence of robust DBS competition, EchoStar and Directsat have already shown that the Commission's current program access rules are insufficient to curb anti-competitive vertical foreclosure. This is because, as BellSouth and America Satellite Network, Inc. correctly point out, the rules do not specifically prohibit the exercise of monopsony power by cable operators to coerce unaffiliated programmers into discriminatory behavior, and because they allow cable operators to get away with price differentials based on phantom cost differences or non-existent economies of scale.

The PRIMESTAR consent decrees similarly do not reach those types of competitive conduct and the expiration provisions certainly do not mean, as cable interests would have it, that after expiration the Commission should never again impose necessary restrictions on the conduct of cable operators. Certainly, the Justice Department does not consider the PRIMESTAR consent decrees sufficient to prevent anti-competitive practices, nor does it read the expiration provisions as a sign that no further restrictions are necessary. Instead, the Department

recommends structural safeguards which would foreclose cable access to DBS spectrum. Even if the structural safeguards proposed by the Department of Justice are adopted by the Commission (as they should be), the rules on conduct proposed by EchoStar and Directsat are still necessary to effectuate the 1992 Cable Act's prohibition against unfair practices and make meaningful the Commission's program access rules.

EchoStar and Directsat also note that the Department of Justice recognizes the acute anti-competitive concerns arising from PRIMESTAR's proposed Headend-in-the-Sky ("HITS") wholesale distribution service. Accordingly, EchoStar and Directsat support the Department's proposed rules to prevent the creation of yet another bottleneck controlled by large cable operators, with only certain additions to make them more effective. The Department's sophisticated analysis of these concerns demonstrates that the Commission must prevent cable systems from inefficiently favoring the wholesale distribution of DBS service by a cable-affiliated DBS provider over the service of an independent DBS operator that offers more favorable terms than the cable affiliates. Programmers should similarly be prohibited from imposing on independent DBS operators onerous and discriminatory terms that have the effect of restricting wholesale distribution by independent DBS operators. Absent such

restrictions, cable-affiliated DBS wholesalers would have the ability and incentive to leverage their cable television and programming affiliations into the creation of a new bottleneck facility.

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EchoStar Satellite Corporation ("EchoStar") and Directsat Corporation ("Directsat") hereby submit these joint reply comments in response to the Commission's Notice of Proposed Rulemaking ("NPRM") in the above-captioned proceeding.

I. THE COMMISSION LACKS THE AUTHORITY TO AUCTION DBS CHANNELS

EchoStar and Directsat have shown in their Comments that the auction proposed in the NPRM: (1) would violate the Commission's own cut-off rules by ushering in new, untimely applicants; (2) would expropriate EchoStar's and Directsat's multi-million dollar investments, made in reliance on their Continental rights to receive additional channels; and (3) infringe EchoStar's and Directsat's right to substantive due process. EchoStar and Directsat have also shown that the

Commission lacks the statutory authority under the Omnibus Budget Reconciliation Act of 1993 ("OBRA") to conduct auctions: (1) because it has utterly failed to explore non-auction alternatives for resolving mutual exclusivity (and indeed is trying to create mutual exclusivity where none existed); (2) because the Commission's proposal fails to satisfy the statutory criteria for determining whether an auction is appropriate, including the speedy and efficient use of the spectrum and promotion of competition; (3) because it is the application of the non-auction methodology already adopted by the Commission in Continental that best satisfies these criteria; and (4) because auctions would be irrational as a matter of policy.

No other commenter has cast any serious doubt on these conclusions. MCI's pleas for the abandonment of the Continental methodology are premised on wrong assumptions and are opportunistic, as they come from a latecomer that failed to apply for a DBS license in a timely manner. Many other commenters have identified serious statutory defects in the Commission's proposal, including the question of whether a permit covering Advanced's canceled channels qualifies as an initial license, see Direct Broadcast Satellite Corporation ("DBSC") Comments at 9-10, and whether the provision of DBS services will exclusively and necessarily consist of subscription services, see Advanced

Communications Corporation ("Advanced") Comments at 3.

Commenters have also noted that the NPRM fails to promote the dissemination of licenses to small or minority-owned businesses, see 47 U.S.C. § 309 (j)(3); see Advanced Comments at 10.

Further, the position taken by DirectTV in support of auctions and the rationale for this position -- Hughes's desire to delay competition -- establishes beyond dispute that an auction will fail to satisfy the statutory criterion of expeditious service to the public. Lastly, several of the comments vividly illustrate that an auction would be irrational, since it would have the same unacceptable consequences as an auction for any other satellite service.

Tempo's and PRIMESTAR's request that an auction be conditioned on the outcome of the appellate Advanced proceeding, see Tempo Comments at 39, PRIMESTAR Comments at 38, should also serve as a reminder that Tempo and PRIMESTAR would inherently have an unfair advantage in an auction: all other parties would be negatively affected by that condition and would have to take it into account as a risk in determining whether and how much to bid; on the other hand, Tempo and PRIMESTAR alone would be favored by the condition, as its satisfaction would simply allow them to consummate the purchase of Advanced's channels. The

Commission should not conduct an auction that discriminates unfairly in favor of the cable interests in this way.

A. MCI'S Attack On Continental Is Wrong And Opportunistic

In questioning the suitability of the Continental methodology, MCI and other commenters make the same erroneous assumption set forth in the NPRM -- i.e., that application of Continental would result in the division of the canceled channels at 110° W.L. into 6 meaningless fragments, see MCI Comments at 3; see also PRIMESTAR Comments at 9; GE Americom Communications at 16-17. However, nothing in Continental requires such fragmentation or precludes the aggregation of the additional channels to which the Continental permittees are entitled with their existing assignments. MCI is also wrong in asserting that the Continental method for reassigning canceled channels "was premised on the assumption that a DBS system employing fewer than ten channels would be commercially viable." Id. at 3. In fact, the Commission's decision to reserve additional channels for DBS permittees can only be construed as being based upon the opposite assumption -- i.e., that these permittees needed extra channels to be commercially viable.

In any event, MCI conveniently ignores the fact that, whether or not the Continental methodology is efficient (which it

is), and whether or not the Commission decides to reassign these channels pursuant to a method other than Continental (which it should not), MCI is still an untimely applicant outside the current DBS processing round and cannot have equal status with those applicants that filed by the 1989 cut-off date. Of course, the pendency of the Continental processing round does not mean that there will never be a new DBS processing round, in which the Commission will be free to design a new method for resolving mutual exclusivity. Thus, once the rights of Continental applicants to additional channels have been satisfied, the Continental processing round will have been completed.

Thereafter, if the Commission cancels the permit of another DBS permittee or finds additional DBS channels, the newly available channels can be opened up to a new processing round. While the Commission may lack the authority to conduct an auction even in those circumstances, and while EchoStar and Directsat cannot foretell their position with respect to such an auction, many of EchoStar's and Directsat's current objections would then be attenuated.

B. The Rationale Underlying Hughes' Position On Auctions Proves That An Auction Would Not Satisfy The Statutory Objectives Of Expedition, Competition And Efficiency

EchoStar and Directsat have shown in their Comments that an auction would not satisfy the criteria enunciated by OBRA for determining the appropriateness of an auction. In particular, an auction would not promote the development and rapid deployment of new technologies, economic opportunity and competition or the efficient and intensive use of the spectrum, see 47 U.S.C. § 309(j)(3); DBSC at 8-9 ("[T]he NPRM glosses over the delays which the auction process will create."); Advanced Comments at 6-7. By contrast, the intelligent application of Continental would satisfy all of those statutory objectives and would ensure that all three full-CONUS slots are fully utilized by 1996, and that all DBS satellites whose construction is complete or underway are utilized by 1997.

In its comments, DirectTV supports the Commission's proposal, even though it generally opposes use of auctions in the satellite area, on the purported ground that this case presents "special circumstances" that apparently make an auction appropriate. As discussed below, however, there are no such special circumstances here. To the contrary, auctions are inappropriate to assign DBS channels for precisely the same reasons that they are inappropriate for other satellite services.

Indeed, the only "special circumstance" invoked by DirectTV to justify the inconsistency in its position is that Advanced "for over a decade warehoused two DBS orbital locations and the public has nothing to show for it." DirectTV Comments at 5. Such circumstances have nothing to do with whether an auction is or is not appropriate. If an FSS licensee warehoused its orbital locations for a decade and subsequently lost its authorization just like Advanced, DirectTV would presumably oppose the auctioning of FSS orbital locations.

Indeed, the apparent impetus for DirectTV's deviation from its normal opposition to satellite auctions and its embracement of the Commission's auction proposal provides further evidence that an auction in this case would not accomplish the objectives of the OBRA. The Commission need look no further than an interview given by Mr. Michael T. Smith, Vice Chairman of Hughes Electronics Corporation, DirectTV's ultimate parent. In that interview, Mr. Smith states:

It is fortuitous that MCI has raised the issue of auction [for a DBS license]. We ordinarily do not support auctions, but in this case, it is going to help us because it is going to delay the process of a competitor using that orbital slot.

Newsmaker Forum, SPACE NEWS (Oct. 9-15, 1995) at 22 (Appendix 1 hereto). Later in the same interview, Mr. Smith repeats that,

while DirecTV does not support auctions normally, "in this case, it is to our benefit because it will delay the process of our competitor." Id.

C. The Proposed Auction Of DBS Channels Would Handicap U.S. Operators And Invite Auctions By Foreign Administrations

Several commenters emphasize that they consider auctions for satellite services inappropriate, and suggest that, if the Commission were to conduct an auction, it should find that an auction is appropriate only in the unique circumstances of this case. See, e.g., Lockheed Martin Corporation ("Lockheed Martin") Comments at 2, 9, Panamsat Corporation Comments at 4, DirecTV Comments at 5; GE American Communications, Inc. ("GE Americom") Comments at 17-18. However, the relevant circumstances of this case are not distinguishable from those of any other satellite service. The very same characteristics that make auctions inappropriate for satellite services generally are equally applicable here.

First, the potential for international service is common to DBS and other satellite services. International service not only is technically possible from the DBS orbital slots allotted to the United States, it is also a highly desirable goal that the Commission should pursue in light of the

substantial benefits that would be provided to the public. International DBS service by U.S. licensees is important to the welfare of the U.S. DBS industry. See Tempo Comments at 28-30. Such service would generate additional overall revenue for U.S. providers; it would result in more jobs in the distribution and programming industries as well as in other ancillary businesses; it would provide advertisers with a single, high-visibility forum for international campaigns and open up new markets for U.S. products; and it would facilitate the dissemination of democratic ideals abroad. In this regard, a DBS system is no different than any other satellite system with the potential for international service. An auction would stifle the ability of DBS operators to offer international service just as it would compromise any other satellite system's ability to provide international service by inviting other countries to follow the Commission's lead and require auctions or other payments of U.S. licensees. See Lockheed Martin Comments at 4-6.

The fact that the BSS allotment plan is currently premised on domestic use, see MCI Comments at 6, Lockheed Martin Comments at 8-9, does not make DBS any different from domestic FSS, which currently is limited to the provision of ancillary international services. Nor should the Commission decide to refrain from pursuing international DBS prospects for the sake of

distinguishing DBS from other international services, as this would forego the immense public benefits of allowing domestic DBS licensees to serve other countries. Similarly, the Commission should not refrain from eliminating the FSS domestic-international distinction for the FSS merely to further its auction policies.¹⁴

Second, the interests of foreign entities in obtaining access to the U.S. market is also a common trait of DBS and other satellite services. EchoStar and Directsat have already pointed out that foreign entities can freely lease transponders on any high-power Ku-band satellite and provide service that is similar to DBS. The Canadian company Alphastar has already leased transponders on AT&T's Telstar 402R satellite for this purpose. Furthermore, foreign-licensed DBS operators, using orbital slots allocated to their countries (many of them capable of full-CONUS service), most likely will be applying to the Commission for

¹⁴ GE Americom urges the Commission "not to decide here -- in this highly expedited proceeding -- whether to auction DBS satellites used in international service." GE Americom Comments at 19. If, however, the Commission were to auction the 110° W.L. and 148° W.L. slots, and if it were subsequently to allow international DBS service, the auctioning of international service capacity feared by GE Americom would have already happened. Thus, the only two ways of satisfying GE Americom's request are: (a) not to auction the 110° W.L. and 119° W.L. slots; or (b) to decide, in this expedited proceeding, that international service from the 110° W.L. and 148° W.L. slots will not be permitted for the sake of auctioning the slots. This latter course would clearly be against the public interest.

authority to operate in the United States. Indeed, Tempo urges the Commission to "assist U.S. companies in their efforts to acquire or lease channels on non-U.S. licensed space stations that could be used to increase DBS resources and competition," Tempo Comments at 30. All of these operators, as well as any U.S. company using transponders on foreign-licensed satellites, would enjoy a huge cost advantage over their U.S.-licensed competitors operating from U.S. orbital locations if the Commission were to conduct the proposed auction. The right to provide DBS service, granted free of charge to foreign operators upon whose qualifications the Commission has never passed, could cost duly licensed U.S. operators hundreds of millions of dollars. Thus, an auction of DBS spectrum would irrationally handicap U.S. licensees vis-à-vis foreign operators.

The Commission well knows that any effort to avoid this dilemma by auctioning authorizations or requiring auction-equivalent payments to foreign operators presents its own insurmountable legal problems as well as practical concerns. In any event, the Commission should not resolve this issue any differently in this proceeding than for any other satellite service where an auction would create a similar handicap as against foreign-licensed satellite systems. As with respect to the international potential of DBS, the Commission cannot

possibly assert that the DBS spectrum is "unique" or distinguishable from other satellite services as requested by some commenters. Rather, an auction here would present exactly the same types of problems as an auction of any satellite service, domestic or international, where foreign-licensed operators may seek authorizations in the United States.

D. An Auction Of DBS Channels Now Would Unjustly Enrich DirectTV

As EchoStar and Directsat have pointed out in their comments, an auction of 28 channels at 110° W.L. will unjustly enrich DirectTV. DirectTV will have obtained access to 27 (or, with USSB, 32) full-CONUS channels at the best orbital location for free, whereas access to a comparable number of channels and quality will most likely cost hundreds of millions of dollars to anyone else. While this is one more factor militating against auctions, the Commission should dismiss Continental Cablevision's outrageous suggestion that such enrichment be addressed by the retroactive requirement of a comparable payment by incumbent DBS permittees.²⁴ Such a penal measure would be totally unjustified;

²⁴ See Continental Cablevision Comments at 21-22. EchoStar and Directsat will not be enriched at all by the proposed auction. EchoStar and Directsat would not be able to attain competitive parity with USSB and DirectTV unless they paid for additional channels that DirectTV received for free.

it would undermine the faith of entrepreneurs in the Commission's processes and keep them from investing in licensed services for fear that the Commission might later choose to add significant spectrum fees.

II. THE COMMISSION SHOULD PROHIBIT THE ACQUISITION OF DBS CHANNELS BY DOMINANT MVPDS, INCLUDING LARGE CABLE OPERATORS, BUT SHOULD NOT IMPOSE A PRIOR RESTRICTION ON ACQUISITIONS BY NON-DOMINANT MVPDS

A. An Outright Prohibition Of Acquisitions Of DBS Channels By Large Cable Operators Is In The Public Interest And Supported By The Record

Tempo and other cable interests predictably oppose any structural or conduct restrictions on cable operators or their affiliates. With respect to the restrictions on the acquisition of DBS channels, Tempo alleges that both Congress and the Commission have declined to impose a cable/DBS cross-ownership ban, Tempo Comments at 12; and that such a ban lacks factual support, id. These arguments are meritless. While Tempo correctly points out that Congress did not impose a cable/DBS cross-ownership ban in 1992, it omits the legislative history accompanying the 1992 Cable Act. The very Conference Report cited by Tempo explains:

In view of the fact that there are no DBS systems operating in the United States at this time, it would be premature to require the adoption of

limitations now. However, the conferees expect the Commission to exercise its existing authority to adopt such limitations should it be determined that such limitations would serve the public interest.^{3/}

Tempo is thus wrong in asserting that "[n]othing has changed since these determinations not to adopt a ban on the participation of cable-affiliated firms in the DBS business." Tempo Comments at 11. What has changed is that today there are two DBS operators and there will soon be another two operators in the United States.^{4/} More importantly, while Congress did not require the Commission to impose a cross-ownership ban, the Conference Report makes clear that the Commission has the authority to do so. In fact, the absence of an outright prohibition in the statute heightens the need for Commission vigilance and the fashioning of appropriate structural restrictions.

^{3/} Conference Report on S.12, Cable Television Consumer Protection and Competition Act, 102d Cong., 2d Sess., 138 Cong. Rec. H8329 (daily ed. Sept. 14, 1992)(emphasis added).

^{4/} Similarly, the Commission's 1992 decision to allow Tempo into the DBS business was based on the embryonic state of DBS. See Tempo Satellite, Inc., 7 FCC Rcd. 2728, 2730 (1992). Today, DBS is far past that stage and there is clearly no shortage of cable-unaffiliated capital attracted to it. In any case, in Tempo the Commission was considering only whether Tempo should be authorized to use 11 DBS channels.

Contrary to Tempo's remaining argument, a ban on acquisitions of DBS channels by large cable operators is unquestionably supported by the record in this proceeding. The only facts that need to be established for the Commission reasonably to conclude that a cross-ownership ban is appropriate are: (1) the dominant position of large cable operators in the MVPD market; and (2) the unequivocal statements of TCI's President and the Justice Department's expert assessment that a DBS operator will not compete, much less compete vigorously, against its affiliated cable television systems.

1. Large Cable Operators Dominate The MVPD Market

The dominant position of large cable operators in the MVPD market cannot be seriously disputed by any party. Congress has recognized this fact and has tasked the Commission with promoting effective competition in the MVPD market. The Commission has reaffirmed the finding of cable operator dominance in its annual inquiry into the state of the market.^{5/} Indeed, that inquiry provides the Commission with a complete record which

^{5/} In the Matter of Implementation of Section 19 of the Cable Television Consumer Protection and Competition Act of 1992; Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, First Report, CS Docket No. 94-48, 9 FCC Rcd. 7442, 7449 (rel. Sept. 28, 1994) ("1994 Cable Report").

uniquely equips it to judge the degree of dominance enjoyed by cable operators in the United States.

The cable interests appear to argue that the Commission need not impose any structural restrictions on them because DBS is a "competitive business," and PRIMESTAR would control merely 24.6% of that business. See, e.g., Continental Cablevision Comments at 10, 12. Yet the cable commenters themselves concede that the entire MVPD market is the relevant market for purposes of assessing concentration. See Tempo Comments at 14; Continental Cablevision Comments at 14. A structural prohibition on cable affiliates is not necessitated by PRIMESTAR's share of the DBS submarket alone, but rather by the stranglehold enjoyed by large cable operators in most local markets. PRIMESTAR's share of the DBS business merely adds to the dominant position of large cable system operators.^{5/}

Continental Cablevision cannot seriously believe that the MVPD market is "increasingly competitive," Continental Cablevision Comments at 14. As DirectTV correctly points out, cable operators serve over 63 million subscribers and still enjoy

^{5/} Of course, EchoStar and Directsat also recognize that DBS may be a relevant sub-market, where concentration problems may arise and should be addressed by the Commission on a case-by-case basis.