

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20054**

In the Matter of)	
)	
Annual Assessment of the Status of)	MB Docket No. 02-145
Competition in the Market for the)	
Delivery of Video Programming)	

**REPLY COMMENTS OF
NATIONAL ASSOCIATION OF BROADCASTERS**

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The National Association of Broadcasters (“NAB”)¹ submits the following reply comments in response to comments filed by EchoStar Satellite Corporation (“EchoStar”) and DIRECTV, Inc. (“DIRECTV”) in the above-captioned matter.

I. INTRODUCTION

EchoStar and DIRECTV have used the occasion of the Commission’s annual inquiry regarding the state of competition in video markets as a forum to argue in favor of the greatest immediate threat to competition in the multichannel video programming distribution (“MVPD”) marketplace: that is, their own proposed merger, which would eliminate all MVPD competition for many millions of consumers, primarily in rural areas, and reduce competition at best to a duopoly in most of the rest of the United States.² The single most decisive step this

¹ The NAB is a nonprofit, incorporated association of television and radio stations and broadcast networks which serves and represents the American broadcast industry.

² EchoStar Comments at 1-9; DIRECTV Comments at 1-2, 13.

Commission could take to promote competition in the MVPD marketplace would be promptly to kill the proposed merger by denying the parties' license transfer application.³

II. BOTH DBS COMPANIES ARE THRIVING AS COMPETITORS

A consistent theme throughout the Commission's eight prior video competition reports has been the rise of DBS as a competitor. The First Report in September 1994 noted that DIRECTV, the first DBS operator, had begun service only two months previously and had 40,000 subscribers.⁴ By the Eighth Annual Report, the Commission counted 16.07 million DBS subscribers or 18.2% of the MVPD total.⁵ Today the number of DBS subscribers is over 18.2 million.

Yet, ironically, the DBS companies ignore this consistent record of growth and success and speak of the "limited success of DBS in acquiring subscribers"⁶ and warn that "if recent trends continue, DBS will be less able to offer a competitive alternative to cable"⁷ These comments are consistent with the DBS operators' dire warnings in their merger proceeding of a "profound risk" that "customers will abandon the DBS platform" absent the merger.⁸

³ Consolidated Application for Authority to Transfer Control of EchoStar Communications Corp., General Motors Corp. and Hughes Electronics Corp., No. 01-348 (filed Dec. 3, 2001) ("Consolidated Application").

⁴ Implementation of Section 19 of the 1992 Cable Television Consumer Protection Act (Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming), First Report, 9 FCC Rcd 7442, 7474-75 (1994).

⁵ Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, Eighth Annual Report, 17 FCC Rcd 1244, 1247 (2002).

⁶ EchoStar Comments at 1 (emphasis added).

⁷ *Id.* at 2.

⁸ Opposition to Petitions to Deny and Reply Comments of General Motors Corp. and Hughes Electronics Corp. and EchoStar Communications Corp., No. 01-348, at 38 (filed Feb. 25, 2002). ("Opposition").

These Cassandra-like predictions, issued to promote their merger, match neither the facts nor what the DBS operators tell the financial community. The reality is that both DBS companies have just reported their strongest results to date and continue to take market share from cable. EchoStar revenues for Q2 2002 were \$1.169 billion, up 21% over the year earlier quarter; its operating income was \$146 million, more than double Q2 2001; and its EBITDA was \$237 million, up over \$100 million from Q2 2001, due “primarily [to] increased subscribers.”⁹ Net new subscribers were up by 295,000 in the second quarter to 7.46 million, an increase of 23% over the prior year.¹⁰ EchoStar will shortly be the fourth largest MVPD.¹¹

For its part, DIRECTV’s revenues were up by 15% in the second quarter to \$1.549 billion, “primarily due to subscriber growth” and its EBITDA of \$148 million was almost double the year earlier result.¹² DIRECTV added 202,00 subscribers in the second quarter for a total of 10.74 million. If DIRECTV meets its target of 250-300,000 net new subscribers in Q3, it will likely pull ahead of Time Warner to become the second largest MVPD.¹³ Hughes President and Chief Executive Officer, Jack Shaw reported that “[t]he improving financial performance at DIRECTV U.S. continues to fuel Hughes’ growth . . . because the operating performance of the business continues to improve, we are increasing DIRECTV U.S. full year estimates for revenue and EBITDA, while maintaining our year-end subscriber guidance” (of 1.2 million net new subscribers).¹⁴

⁹ EchoStar Second Quarter 2002 Earnings Release (August 15, 2002).

¹⁰ *Id.*

¹¹ EchoStar will rank behind only AT&T Comcast, DIRECTV, and AOL Time Warner once the AT&T Comcast merger closes.

¹² Hughes Electronic Corp., Second Quarter 2002 Earnings Release (July 15, 2002).

¹³ With the restructuring of the Advance/Newhouse partnership, Time Warner Cable will have 10.8 million subscribers. AOL Time Warner Q2 2002 Earnings Release. DIRECTV’s guidance indicates that it will have 11 million subscribers at the end of this quarter.

¹⁴ DIRECTV Second Quarter Earnings Release.

This strong growth by the two DBS companies is particularly impressive given that basic cable growth has been “flat”, with the top seven cable companies together actually losing subscribers in the first quarter of 2002.¹⁵ The steadily improving competitive posture of the DBS companies can be attributed in large part to the fierce head-to-head competition between EchoStar and DIRECTV in every possible dimension (at the same time that they became the only U.S. licensees of high-power full-CONUS Ku-band spectrum). EchoStar and DIRECTV compete vigorously on the price of equipment, installation and programming; they compete to offer the most attractive programming packages (e.g., DIRECTV’s NFL Sunday Ticket, EchoStar’s many varieties of ethnic programming, etc.); they compete for the allegiance of dealers and retailers; they compete to offer technologically advanced products such as interactive service and personal video recorders; and most significantly, they compete to offer local broadcast stations to local markets.

III. ECHOSTAR AND DIRECTV COMPETE IN OFFERING LOCAL-TO-LOCAL

EchoStar claims that consumers will benefit “if DBS is permitted to offer local service in all DMAs” by merging.¹⁶ This is a strange claim. It is precisely because the two DBS companies were strong rivals and had not merged that local-to-local came to be, and it was EchoStar that was the impetus for local-to-local. What happened was that EchoStar, as the second and underdog DBS provider, initiated and advocated the concept of offering the retransmission of local stations into their markets. DIRECTV, as the more established player, resisted this concept. Then, under competitive pressure, DIRECTV changed course and announced that it too supported the concept of local-to-local, and generated technical innovations to make this concept a reality.

¹⁵ David Lieberman, *Cable Wait on Large Tech Investment to Payoff*, USA Today, May 12, 2002.

¹⁶ EchoStar Comments at 6.

Once the Satellite Home Viewer Improvement Act was passed, the two DBS companies immediately started to add local markets, with one company's announcement of a particular local market often followed quickly by a similar announcement of carriage of that market by the second company.¹⁷ Despite its later start, DIRECTV has now leapfrogged EchoStar in its capability to offer local markets. DIRECTV recently announced that it will soon begin transmitting local channels to its 50th local market and will reach 51 by year-end.¹⁸ EchoStar now serves 43 local markets.¹⁹ When DIRECTV launches its DIRECTV 7S spot-beam satellite, it will have the capacity to serve 103 markets.²⁰

Although the parties claim that DIRECTV will choose to serve only 70 markets,²¹ there are reasons for skepticism about this self-imposed limitation. First, adding a local market gives a DBS company a powerful "lift" in subscribers, reduces its churn considerably, and gives it substantial additional subscriber revenues. Second, EchoStar and DIRECTV have consistently "low-balled" their estimates to the Commission and Congress about their local carriage plans. When the parties first sought merger approval they indicated that even with spot-beam satellite and other new technologies they still could only serve approximately 100 local markets.²²

¹⁷ For instance, EchoStar began offering local programming in 13 markets on November 29, 1999. DIRECTV immediately matched these offerings in 11 of the 13 markets and added the other two a few months later. Later in 1999, DIRECTV began local-to-local service in six markets not served by EchoStar and EchoStar immediately began offering local service in two of these markets and added the other four over the next four months. This jockeying for position is detailed in the Petition to Deny of National Association of Broadcasters, No. 01-348 at 20-24 (filed Feb. 4, 2002).

¹⁸ DIRECTV Press Release, DIRECTV to Offer Local Channels In New Orleans (Aug. 6, 2002).

¹⁹ See <http://www.dishnetwork.com/content/programming/locals/index.shtml>.

²⁰ Opposition at 13-14.

²¹ *Id.*

²² Consolidated Application at 28-29; *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., at 6 (Dec. 4, 2001) (statement of Charles

Only after it became clear that their merger was in trouble did they miraculously find a way to provide local carriage in all 210 DMAs.²³ Indeed, as expert engineers have demonstrated, it would be quite feasible for EchoStar and DIRECTV each individually to carry all local television channels in all 210 DMAs by taking advantage of technological advances in areas such as compression and spot-beam frequency reuse or by using other presently available technologies such as 8-phase PSK modulation or reverse band working.²⁴ Alternatively, EchoStar and DIRECTV could form a joint venture to carry all local channels while continuing to compete with one another in all other aspects. The parties admit they discussed such a joint venture; they simply failed to reach an acceptable business deal and instead opted for their anticompetitive merger proposal.

Given this track record, it is far more prudent for the Commission to rely on market forces for the extension of local-to-local carriage. It is competition between EchoStar and

Ergen, Chairman and CEO, EchoStar Communications Corporation) (“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.”).

²³ Even then, EchoStar quickly took back its “promise” by telling the Supreme Court it would not honor the pledge if it won its “Must Carry” case. *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). While EchoStar lost that case, its almost instantaneous backtracking evinces a mindset that makes any such promise unreliable, especially given EchoStar’s record of “‘disingenuous’ behavior and lack of candor.” *In re National Association of Broadcasters and Association of Local Television Stations*, DA 02-765, CSR-5865-X, at 19 n.116 (Media Bureau Apr. 4, 2002).

²⁴ See Declaration of Richard G. Gould in support of Petition to Deny of National Association of Broadcasters (included as Appendix C) (filed Feb. 4, 2002); Supplemental Declaration of Richard G. Gould on behalf of National Association of Broadcasters (included as Appendix B) (filed Apr. 25, 2002); Further Supplemental Declaration of Richard G. Gould on behalf of National Association of Broadcasters (filed May 30, 2002); Declaration of Walter L. Morgan in support of Petition to Deny by the National Rural Telecommunications Cooperative (included as Appendix O) (filed Feb. 4, 2002); Reply Declaration of Walter L. Morgan on behalf of the National Rural Telecommunications Cooperative (filed April 4, 2002); Affidavit and Report of Roger J. Rusch in support of Pegasus Communications Corporation’s Petition to Deny (included as Attachment B) (filed Feb. 4, 2002).

DIRECTV that has driven provision of local carriage to the number of markets served today and it is their continued rivalry that is the best guarantee of the further expansion of local carriage into additional markets.

IV. ECHOSTAR AND DIRECTV PROPOSE A MERGER TO MONOPOLY IN MANY MARKETS AND AT BEST TO DUOPOLY IN MOST OTHER MARKETS

A. Merger to Monopoly for Millions of Consumers. EchoStar and DIRECTV cannot deny that for large numbers of Americans, particularly in rural areas, a merger between the two would create an MVPD monopoly. Exactly how many millions of consumers would be subject to this monopoly because their homes are not passed by cable is a subject of much debate. What is clear is that the Commission's use of a 97% figure for homes passed by cable is flawed.²⁵ Indeed, the NTIA and the Rural Utilities Service indicate that the correct figure may be as low as 81%.²⁶

Significantly, while the merger proponents attempt to minimize the number of consumers who would be subject to a monopoly, DIRECTV's internal data show that 29% of its subscribers alone (over 3 million) have no access to cable.²⁷ In fact, a conservative estimate is that more than 20 million households will ultimately be subject to an MVPD monopoly if this merger proceeds.²⁸ As EchoStar once put it:

²⁵ National Rural Telecommunications Cooperative Comments at 3-8.

²⁶ 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).

²⁷ 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 cable television service").

²⁸ The calculation is as follows. Assume the same proportion of EchoStar as DIRECTV subscribers have no access to cable (a conservative assumption given EchoStar's rural skew). This totals well over five million DBS subscribers with no cable access (as well as an

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.²⁹

B. At Best a Merger to Duopoly in Most Other Markets. For most consumers for whom the merger will not create a monopoly MVPD provider, the result will be at best a duopoly, which will eliminate the vigorous head-to-head competition between EchoStar and DIRECTV. In fact, EchoStar's pre-merger position was that DBS is a separate market,³⁰ hence the proposed merger would result in a monopoly everywhere. Even if viewed as an overall MVPD market, the merger would eliminate what are clearly the two closest competitors.³¹ As courts have consistently held, the creation of such a duopoly, particularly when the closest

unascertainable number of households with no cable access who do not subscribe to DBS). Add to this total the over 8.2 million subscribers to outmoded analog cable systems which "could become extinct over the next five to eight years" because their economics cannot justify an upgrade to digital cable/cable modem service. Credit Suisse First Boston Equity Research, Natural Selection: *DBS Should Thrive as the Fittest to Serve Rural America*, at 3 (Oct. 12, 2001). Because rural cable penetration is about 54 percent, this suggests that 15 million households are in cabled areas likely soon to be subject to a DBS monopoly if the merger is approved. Adding this total to the 5 million-plus DBS subscribers who live in uncabled areas totals over 20 million (and this number does not include non-DBS subscribers who live in areas not passed by cable).

²⁹ 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.*, No. 00-K-212, at 12 (D. Colo. Nov. 6, 2000).

³⁰ "The relevant market for this case is not the MVPD Market, but rather a submarket of the MVPD Market known as the High Power DBS Market. . . . EchoStar does not dispute that there is an MVPD Market and that both EchoStar and DIRECTV compete with cable companies in that market. *However, the DBS Market is an appropriate submarket of the MVPD market for antitrust purposes.*" *Id.* at 7-8 (emphasis added).

³¹ EchoStar told the antitrust court that "EchoStar is DIRECTV's closest competitor . . . [and they] react primarily to each other when setting equipment and service prices;" *Id.* at 12.

substitute is eliminated, is routinely condemned under the antitrust laws. FTC v. H.J. Heinz Co., 246 F.3d 708 (D.C. Cir. 2001).

C. The DBS Companies' Proposal to Lessen the Anti-Competitive Effect of the Merger Is Flawed and Unavailing. NAB's economic expert Gregory Sidak, demonstrated that the reduction in competition caused by the merger would create a consumer welfare loss of approximately \$3 billion over five years.³² Similar conclusions were reached by Professors MacAvoy and Rubinfeld on behalf of NRTC and Pegasus.³³

EchoStar's and DIRECTV's proposal to avoid these consumer losses by providing a "national" pricing plan based on what they would charge in urban markets is fatally flawed. First, standard economics predicts that the single national price still would be supracompetitive, at a level somewhere between the rural (monopoly) and urban (duopoly) price. Second, an even greater flaw is that a national pricing plan is completely unenforceable. There are simply too many program packages and opportunities for special promotional offers for programming, equipment sales and installation to establish, much less enforce, a national price. EchoStar's Chairman and CEO Charles Ergen himself explained the need to be able to price discriminate geographically: "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."³⁴ A very simple method of price discrimination (and one used by the DBS companies in the past)

³² Declaration of J. Gregory Sidak in Support of Petition to Deny of National Association of Broadcasters, ¶ 51 (included as Appendix B) (filed Feb. 4, 2002).

³³ Declaration of Paul W. MacAvoy in Support of Petition to Deny of National Rural Telecommunications Cooperative (included as Appendix I) (filed Feb. 4, 2002); Affidavit of Daniel J. Rubinfeld in Support of Petition to Deny of Pegasus Communications Corporation (included as Attachment A) (filed Feb. 4, 2002).

³⁴ *Ergen Makes His Case*, Satellite Bus. News, Dec. 31, 2000, at 11.

would be to offer a special discount for anyone who produces a cable bill—thus limiting the promotion to cabled areas. With today's data mining technology there are an infinite number of ways that discounts can and would be tailored by customer type or location. Further, a national pricing plan, even if feasible, which it is not, would simply facilitate price coordination. The national pricing proposal should be recognized for what it is: a porous proposal, laden with caveats, which, even if attempted, would involve the Commission in an unending morass of utility-type rate regulation.

CONCLUSION

The intense rivalry between EchoStar and DIRECTV has spurred technological innovation resulting in expanded services and program offerings, including a rapid expansion in the number of markets where local-to-local is being provided. This rivalry has also spurred vigorous price competition in providing these services and program offerings. The merger of EchoStar and DIRECTV would be contrary to the public interest. It would dramatically lessen competition in MVPD markets across the U.S., creating a monopoly in many markets and at best a duopoly in most others. Its anticompetitive effects cannot be avoided by jury-rigged solutions, such as an unenforceable national pricing plan. The Commission should promote competition in MVPD markets by denying the transfer of control application requested by EchoStar and DIRECTV.

Respectfully Submitted,



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