Before the
Federal Communications Commission
Washington, D.C. 20554

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

REPLY COMMENTS OF ECHOSTAR SATELLITE CORPORATION

EchoStar Satellite Corporation ("EchoStar") hereby submits its Reply Comments in the above-captioned proceeding, addressing two issues in particular. First, contrary to the assertions of the cable industry in this proceeding, there ought to be no question about cable operators' continuing market power. Second, despite the attempts of the National Rural Telecommunications Cooperative ("NRTC") to cast aspersions on the pending merger between EchoStar and Hughes Electronics Corporation ("Hughes"), the merger remains the best hope to bolster competition against the entrenched and consolidating cable industry.

I. CABLE OPERATORS STILL DOMINATE THE MVPD MARKET

The cable industry attempts to refute its market power by discounting the importance of its nearly 80% nationwide market share.[1] This attempt must fail. First, it relies on a "fig leaf" argument – a statement from the D.C. Circuit's decision in *Time*

[1] *See* Comments of the National Cable and Telecommunications Association (dated July 29, 2002) at 7 ("NCTA Comments"); *see also* Comments of AT&T Corporation (dated July 29, 2002) at 7 ("AT&T Comments").

Warner Entertainment Co. v. FCC[2] ("*Time Warner II*") that, normally, market share is not the "only" element to consider in a market power analysis, but that elasticities of supply and demand also may be taken into account. From that statement, the court concluded that, in revising the cable horizontal ownership cap, the Commission will have to consider the impact of DBS.[3] Reliance on this discussion is misplaced: even if it were not dictum,[4] AT&T is wrong that it *requires* the Commission to conclude that "DBS's ubiquitous nationwide availability and its ability to easily expand output effectively prevent cable operators from exercising market power."[5] The court required no such thing. At most, the court was simply indicating that the Commission in its cable horizontal cap proceeding will consider the impact of DBS, among other factors. Evaluation of that factor in this proceeding, however, would not alter one iota of the Commission's conclusion that cable operators continue to dominate the MVPD market.

Second, and most important, the Commission need look no further than to the continuing, above-inflation cable rate increases. These rate hikes are dispositive proof both of the continuing (and increasing) cable dominance and of DBS's current inability to discipline cable. As discussed below, extensive evidence shows that DBS indeed does not constrain cable's exercise of market power.

To that, NCTA responds that "the rate at which prices increase implies absolutely nothing about market power,"[6] based on the tired theory that the fundamental source of price growth is increasing costs. Relying on that hypothesized nexus, NCTA's expert

---

[2] 240 F.3d 1126 (D.C. Cir. 2001).
[3] *Id.* at 1134.
[4] The character of the statement as dictum is clear: after stating that cable industry petitioners "misconstrue[d]" the statutory standard at issue in the case, the court nevertheless "pause[d]" to discuss the relationship between market share and market power. *Time Warner II,* 240 F.3d at 1133-34.
[5] AT&T Comments at p. 7 (citing *Time Warner II,* 240 F.3d at 1133-34).
[6] NCTA Comments at p. 9.

economist questions whether a firm with market power would be likely to pass on cost increases to a greater extent than a competitive firm. NCTA quotes Dr. Aron's statement:

> In my experience teaching pricing theory and strategy, and consulting on various pricing issues, I have not seen any general theoretical result in the professional economics literature that describes the degree to which cost increases are passed through as a function of different degrees of market power in oligopoly market structures...[7]

This quote is taken out of context from Dr. Aron's statement and is misleading because it implies that there is no theoretical basis on which to argue that the ability to pass through cost increases is associated with higher degrees of market power. However, elsewhere in her statement, Dr. Aron notes that under certain circumstances, costs may in fact be passed on to a greater extent in a monopoly market than in a perfectly competitive one, a point ignored by NCTA. More generally, there are many theoretical models in which the extent to which cost increases are passed on is directly correlated with the degree of market power present.[8] This is consistent with common sense: a firm with market power is plainly better able to pass through price increases to consumers.

In any event, the premise of Ms. Aron's analysis is false: the cable price increases are not simple cost pass-throughs. If they were, why would they outpace DBS prices even though the DBS providers experience significantly higher programming costs than cable operators? The cable interests never answer that question. Nor do they, or can they, dispute the fact that the DBS operators' programming costs are higher than theirs. Telling in that regard is the complaint, voiced recently by the Chief Executive Officer of Comcast, that "programming costs are by far our biggest single cost[,] about 20% of

---

[7] *Id.*, ¶ 22, Appendix A (emphasis in original).

[8] One example that is commonly employed in the professional economics literature is the Cournot model of competition with constant elasticity of demand.

revenues."[9] EchoStar would love to have that complaint – its programming costs are a much higher percentage of its revenues. If there were any remaining doubt on the subject, here is what Viacom's Mr. Redstone has candidly admitted: "what many people don't know is that satellite broadcasters pay us more for the same programming than cable operators."[10]

Rising costs are a false pretext for yet another reason -- many of the most popular programmers remain affiliated with cable systems. In many cases, therefore, the cost increases that the cable operators bemoan are simply price increases levied by, and benefiting, their own affiliates. Transferring money from one pocket into the other is not enough to explain away the cable rate increases.

Finally, third, cable operators do not persuasively rebut evidence showing that DBS does not impose a significant constraint on cable pricing behavior, at least in the majority of designated market areas ("DMAs"), where DBS does not offer local broadcast channels. This problem is known to the Commission: the 2001 Report on Cable Industry Prices, concluded that, even "where effective competition is achieved as a result of DBS penetration, there is no measurable effect on cable subscriptions, the price of cable service, or the number of channels offered."[11]

EchoStar has now adduced additional evidence to that effect. In the context of the EchoStar/Hughes merger proceeding, the Applicants' economic experts Drs. Robert Willig and Andrew Joskow have found that the introduction of local service by DBS

---

[9] Seth Schiesel, *A Conversation With the Next Mogul of Cable TV*, THE NEW YORK TIMES, May 6, 2002, at C-1.

[10] Sallie Hofmeister, *Q&A -- Redstone Sees More Growth for Viacom*, LOS ANGELES TIMES, November 18, 2001, at C-1.

[11] Federal Communication Commission, *Report on Cable Industry Prices*, In the Matter of Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992, MM Docket No. 92-266 (rel. April 4, 2002), at ¶ 47.

exerts significant downward pressure on cable prices. Drs. Willig and Joskow have quantified that effect by comparing cable pricing in these areas before and after the introduction of local-into-local service, and also by taking into account cable pricing in areas where local-into-local service is not available. The result? Satellite local-into-local service has lowered expanded basic cable prices, or restrained them from increasing, to the tune of about $1.03 per month in the first year and $1.57 per month in the second year following introduction of local-into-local service.[12] Thus, in markets in which DBS does not offer local service – and roughly 160 out of 210 DMAs lack local service from DBS – the available evidence suggests that DBS does not impose a competitive constraint on cable. Indeed, as Drs. Willig and Joskow have concluded, while cable imposes a significant constraint on DBS prices, "it is likely that DBS has reached its maximum competitive impact on cable providers unless DBS providers can reduce their costs or improve their product."[13]

In fact, looking to the future, DBS' competitive constraint on cable providers may diminish further even in areas where DBS provides local-into-local service. In particular, the rollout of digital cable – and the ability to offer broadband bundles and true video-on-demand services – will give cable providers a significant competitive advantage and likely allow the cable industry to strengthen its hold on the MVPD market.[14]

---

[12] *See* Ex Parte Presentation, Drs. Andrew Joskow & Robert Willig, Analysis of the EchoStar-Hughes Merger: Competitive Effects and National Pricing (Public Version) (dated July 2, 2002), at 34 ("July 2, 2002 Competitive Effects Presentation") (filed June 28, 2002).
[13] *See id.* at 55.
[14] *See id.* at 52-56.

II. THE MERGER OF ECHOSTAR AND HUGHES ELECTRONICS WOULD PROMOTE COMPETITION

Given the lack of true competition in the MVPD market, only a strengthened DBS provider carrying local broadcast signals in every market and offering greater choice in services will be able to effectively restrain cable's market power. The proposed merger between EchoStar and Hughes is the only way to achieve spectrum efficiencies necessary to create such competitive pressures on cable. As EchoStar has stated, this is most evident in the ability of New EchoStar to serve all 210 DMAs with local broadcast service, provide more HDTV, Near Video on Demand, ethnic and independent programming, and usher in the first truly competitive residential broadband service by satellite.

For example, as NCTA recognized in its comments, "the battleground between DBS and cable is moving into the video-on-demand [VOD] arena."[15] EchoStar agrees. However, today EchoStar is unable to compete effectively with cable's VOD offerings because cable is able to cache content at servers throughout a franchise area, while DBS must rely on limited bandwidth on satellite frequencies, with on-demand programming available at staggered intervals throughout the day.

The EchoStar/Hughes merger would allow DBS to provide a more competitive response to cable's inherent VOD advantage by increasing the amount of bandwidth devoted to VOD services, thereby decreasing the amount of time satellite subscribers have to wait to receive the on-demand programs they choose or to download content to a personal video recorder. This ultimately would make satellite's VOD product more competitive with, although still not equivalent to, cable's.

---

[15] *See* NCTA Comments at 31.

Similarly, as stated above and as NCTA acknowledges, cable operators' rollout of digital service allows them to expand their capacity and offer a much wider range of programming and broadband services to consumers.[16] DBS providers are constrained from matching this level of service and remaining competitive by a fundamental handicap – finite spectrum capacity. As EchoStar explained in its comments, the EchoStar/Hughes merger would alleviate that handicap.

Finally, as several commenters noted, satellite broadband has not yet lived up to its potential.[17] Nevertheless, the satellite platform is well suited to broadband delivery of high-speed Internet, particularly for rural customers. Cable now dominates the provision of high-speed access service and will continue to do so if the present state of the MVPD market does not change. It is imperative that effective alternatives to cable broadband and DSL be provided to consumers in order to maintain price discipline on cable and counter the stranglehold on the market that cable will continue to have otherwise.[18] These alternatives can best be provided to consumers via the strengthened platform that will be the result of the proposed EchoStar/Hughes merger.[19]

---

[16] *See id.* at 25-26.
[17] *See, e.g.,* Comments of EchoStar Satellite Corporation (dated July 29, 2002) at 6 ("EchoStar Comments") and Comments of Satellite Broadcasting and Communications (dated July 29, 2002) at 9.
[18] *See* EchoStar Comments at 7.
[19] *Id.* at 7.

III. CONCLUSION

EchoStar urges the Commission to take the foregoing reply comments into account in its next annual report.

Respectfully submitted,

EchoStar Satellite Corporation

David R. Goodfriend
Director, Legal and Business Affairs
EchoStar Satellite Corporation
1233 20th Street, N.W.
Washington, D.C. 20036

David K. Moskowitz
Senior Vice President
and General Counsel
EchoStar Satellite Corporation
5701 South Santa Fe Drive
Littleton, CO 80120

August 30, 2002