

# Resolving Antitrust Concerns by Facilitating New Entry:

## Observations on the Proposed Merger of EchoStar and DirecTV

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\* Visiting Fellow, American Enterprise Institute. I have been requested by Cablevision to prepare comments on potential remedies to any antitrust concerns that might arise from the proposed merger between EchoStar and DirecTV. While I have no view as to whether any antitrust concerns are sufficient to block the proposed merger, I offer these comments narrowly to suggest the availability of private remedies to any such antitrust concerns that federal agencies may have. These comments are certainly not intended to address any issues unrelated to antitrust concerns. (See H. Furchtgott-Roth, "Another Big Merger, Another Chance for a Shakedown," *Wall Street Journal*, October 30, 2001.) The views expressed in this paper are my own and do not necessarily reflect the views of either Cablevision or the American Enterprise Institute, which does not take institutional positions on regulatory or adjudicatory matters.

## Summary

EchoStar Communications Corporation (EchoStar) has proposed to acquire DirecTV and other assets of Hughes Electronics Corporation (Hughes), a subsidiary of General Motors Corporation (General Motors). The acquisition is currently under review by the Antitrust Division of the Department of Justice (DoJ) and the Federal Communications Commission (FCC). Among other services, both EchoStar and DirecTV currently distribute video programming services via satellite directly to homes across America. If either DoJ or the FCC were to object to the proposed merger, parts of the basis for the objection are likely to be (1) the small number of firms competing directly with EchoStar and DirecTV and (2) the apparent difficulty of entering the market to compete with these firms.

Rejection of the merger by a federal agency would be despite and not because of the imminent entry next year of Rainbow DBS owned by Cablevision Systems Corporation (Cablevision). With its currently proposed configuration, Rainbow DBS by itself would occupy a niche market in the distribution of video programming, but with channel capacity less than either EchoStar or DirecTV today. It would not necessarily be a sufficiently close competitor of a merged EchoStar to address competition concerns.

Some of the difficulties of competing with EchoStar and DirecTV are faced by all firms seeking to distribute video and other programming to American homes while other barriers are specific to satellite-based services, such as the direct broadcast satellite (DBS) services offered by EchoStar and DirecTV. The two most significant barriers peculiar to providing DBS services are (1) obtaining some of the limited number of government licenses necessary to offer DBS services and (2) constructing, launching, and operating a satellite for the DBS services. Today and for the foreseeable future, EchoStar and DirecTV have most of the fixed number of requisite governmental licenses and most of the satellite capacity to provide DBS services.

Many if not all of the voiced antitrust concerns related to the proposed acquisition could be remedied by a private transfer of licenses and a lease of access to an operational satellite by EchoStar to a third party willing to compete directly with the newly merged entity. While a few companies have tentative plans to begin offering DBS services, only Cablevision appears to have a satellite under construction, a launch date, and a business plan with sufficient detail to be a credible near-term entrant to compete directly with the proposed consolidated EchoStar. Moreover, Cablevision has a credible proposal to acquire specific licenses and lease specific satellite capacity from EchoStar as the basis for head-to-head competition with a newly merged EchoStar that may allay antitrust concerns. Other similar proposals involving the private transfer of assets from EchoStar to Cablevision may also address antitrust concerns.

With a transfer of a small number of licenses and a limited lease arrangement for satellite services, both EchoStar and Cablevision would likely be able to provide substantially more video and other services to American consumers than can either current DBS provider. The market for the distribution of video programming, however

defined, would be far more technologically sophisticated and would offer far more services to consumers. Moreover, there would be no fewer suppliers of DBS services than today. The net result of a limited transfer of assets from EchoStar-Hughes to Cablevision would be a substantial potential welfare improvement for the American consumer.

## I. Three stand-alone DBS companies

U.S. households have many different means to obtain information and entertainment. One of the increasingly popular ways is for a household to subscribe to a DBS service that provides large bundles of primarily video programming in exchange for a monthly fee. The household purchases and installs specialized equipment to receive the programming.

### A. *DirecTV and EchoStar*

Currently, DirecTV and EchoStar are the only two facilities-based DBS providers in the United States.<sup>1</sup> DirecTV has approximately 10.7 million subscribers, and EchoStar has roughly 7.46 million subscribers.<sup>2</sup>

EchoStar and DirecTV offer various combinations of services to consumers including packages of video programming, packages of audio programming, and Internet access. These bundled offerings are similar, but not identical, to bundles offered by cable operators and other packagers of video programming. For most of these alternatives, consumers must pay for some or all of the following: (1) specialized equipment to receive packages of programming, (2) installation of equipment in home, and (3) a monthly subscription for bundles of services. The first two of these are fixed costs and must be incurred when a consumer switches from one service provider to another. Nonetheless, consumers can and do switch among MVPD providers.<sup>3</sup>

Both DirecTV and EchoStar operate in the Ku-band. DirecTV has licenses and operates 46 DBS frequency channels:<sup>4</sup> 32 at 101° west longitude (W.L.), 3 at 110° W.L., and 11 at 119° W.L. EchoStar has licenses for and operates 85 DBS frequency channels: 11 at 61.5° W.L., 29 at 110° W.L., 21 at 119° W.L., and 24 at 148° W.L. EchoStar also operates an additional 19 DBS frequency channels at 61.5° W.L. under a grant of Special Temporary Authority from the Commission and through a lease arrangement with Dominion.<sup>5</sup> In addition, EchoStar has requested authority for 11 DBS frequency

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<sup>1</sup> SkyAngel offers a niche DBS service offering comprised solely of religious-oriented programming.

<sup>2</sup> Annual Assessment of the Status of Competition in the Markets for the Delivery of Video Programming, MB Docket No. 02-145, Comments of DirecTV, Inc. at 11 (July 29, 2002); Press Release, EchoStar Communications Corporation, EchoStar Reports Second Quarter 2002 Financial Results (August 15, 2002, available at [http://www.corporate-ir.net/ireye/ir\\_site.zhtml?ticker=dish&script=410&layout=6&item\\_id=325936](http://www.corporate-ir.net/ireye/ir_site.zhtml?ticker=dish&script=410&layout=6&item_id=325936)). Subscriber totals for DirecTV and EchoStar are current as of June 30, 2002.

<sup>3</sup> Declaration of Dr. Robert D. Willig, CS Docket 01-348, at 42-46 (filed Feb. 25, 2002) (demonstrating some level of customer movement between cable, DBS, and broadband service providers).

<sup>4</sup> The Ku-band consists of the 500 MHz from 12.2 GHz to 12.7 GHz of the spectrum. The Ku-band is divided into 16 sub-bands, each with 27 MHz with a 2MHz guard band. In turn, each sub-band can carry two separate blocks of signals, each with a different polarization. Altogether, the Ku-band can then be divided into 32 different spectrum blocks. See Affidavit of R.R. Rusch, C.S. Docket 01-348, (January 31, 2002) at 2. Each of these blocks is commonly referred to as a “DBS frequency channel.”

<sup>5</sup> Policies and Rules for the Direct Broadcast Satellite Service, IB Docket No. 98-21, *Report and Order*, FCC 02-110, ¶¶ 12-13 (rel. June 13, 2002).

channels at 157° W.L.<sup>6</sup> Hughes, PanAmSat (owned by Hughes), and EchoStar have several of the licenses that would be potential locations for a DBS service in the Ka-band.<sup>7</sup> Between them, DirecTV and EchoStar operate 15 DBS satellites in five orbital slots.<sup>8</sup>

*B. Rainbow DBS*

Cablevision controls the licenses for DBS services in 11 of the 32 frequency channels available at 61.5 W.L.<sup>9</sup> Cablevision has under construction a DBS service satellite and a launch date for the satellite in the spring of 2003.<sup>10</sup> Cablevision plans to begin providing nationwide distribution of a third general interest U.S.-based DBS service, to be called Rainbow DBS, by December 2003.<sup>11</sup> The service should be able to reach households in much, if not all, of the continental United States.<sup>12</sup>

Unencumbered by a customer base with equipment that cannot use emerging technologies, Rainbow DBS intends to use new compression technologies, such as

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<sup>6</sup> See Letter from Pantelis Michalopoulos, Counsel for EchoStar Satellite Corporation to Marlene Dortch, Secretary, Federal Communications Commission (dated May 28, 2002) requesting the odd-numbered channels 1-21 (11 channels) at 157° W.L. as the channel assignment for its western DBS permit. See also *In the Matter of EchoStar Corporation for Assignment of DBS Orbital Positions and Channels*, DA 02-1163 (released May 16, 2002) (finding that EchoStar has satisfied the first due diligence requirements and granting EchoStar's request for channel assignment pending further clarification).

<sup>7</sup> Second Round Assignment of Geostationary Satellite Orbit Locations to Fixed Satellite Service Space Stations in the Ka-Band, *Order*, DA 01-1693 at Appendix A (rel. Aug. 3, 2001).

<sup>8</sup> Press Release, EchoStar Communications Corporation, ILS Proton Successfully Launches EchoStar VIII (Aug. 22, 2002), available at [http://www.corporate-ir.net/ireye/ir\\_site.zhtml?ticker=dish&script=410&layout=6&item\\_id=328274](http://www.corporate-ir.net/ireye/ir_site.zhtml?ticker=dish&script=410&layout=6&item_id=328274); Press Release, DirecTV, Inc., DirecTV 5 Satellite to Launch May 6 (April 30, 2002), available at [http://www.directv.com/DTVAPP/aboutus/headline.jsp?id=04\\_30\\_2002A](http://www.directv.com/DTVAPP/aboutus/headline.jsp?id=04_30_2002A).

<sup>9</sup> Petition of R/L DBS Company, L.L.C. for Extension of its Direct Broadcast Satellite Construction Permit, File Nos. DBS 87-01 et al., *Memorandum Opinion and Order*, DA 00-2852, 16 FCC Rcd 9 (rel. Dec. 29, 2000) (“*R/L DBS Extension Order*”).

<sup>10</sup> Letter from Benjamin J. Griffin and Christopher R. Bjornson, Counsel for R/L DBS, to Donald Abelson, Chief, International Bureau (June 27, 2002). See also Ex Parte Presentation of R/L DBS Company, LLC before the Federal Communications Commission, CS Docket 01-348, *Opportunities to Enhance DBS and MVPD Competition in Connection with the EchoStar/DirecTV Merger* (filed Sept. 18, 2002).

<sup>11</sup> *Id.*

<sup>12</sup> Although it appears that DBS signals from a satellite at 61.5 W.L. can reach the Pacific Coast, they can be received by a satellite dish only with a low angle of elevation relative to the horizon, particularly in the Pacific Northwest. Such a low angle means that many physical features, such as hills and vegetation, are more likely to obstruct signals than a satellite dish with a higher angle of elevation. Households in some locations on the West Coast may find it impossible to receive a signal from a satellite at 61.5 W.L., and many others may find it more convenient to use a different service. In most of its proceedings addressing the coverage of DBS services from different orbital slots, the FCC has not considered the 61.5 W.L. slot as providing full continental U.S. (CONUS) coverage. See National Association of Broadcasters and Association of Local Television Stations Request for Modification of Broadcast Carriage Rules for Satellite Carriers, CSR-5865-Z, Declaratory Ruling and Order, DA 02-765, ¶ 6 (rel. Apr. 4, 2002). Nonetheless, it is possible from the 61.5° W.L. orbital location to provide service to most of the contiguous United States, including western locations such as Los Angeles and San Francisco. The design of the Rainbow 1 satellite includes spot beam coverage of the Seattle, Los Angeles, and San Francisco regions. See Ex Parte Presentation of R/L DBS Company, LLC before the Federal Communications Commission, Sept. 18, 2002.

MPEG4, to provide many high-definition and standard-definition programs. With licenses for just 11 DBS frequency channels, however, in contrast to more than 100 between EchoStar and DirecTV, Rainbow DBS does not plan to offer local-into-local broadcast signals.

It remains to be seen whether Rainbow DBS will in fact be a full-fledged competitor with DirecTV and EchoStar or whether it will merely occupy a niche market viewed by only some, but not all, customers as a potential competitor. Rainbow DBS faces three limiting factors: licenses for a small number of frequency channels; only one orbital slot location at 61.5 with difficulty of offering competitive service to the West Coast, particularly in the Pacific Northwest; and currently a plan for a single satellite with little or no redundant backup.<sup>13</sup>

Dominion is the only other Ku-band licensee for DBS services. It has a license for 8 frequency channels at 61.5 W.L. It leases 6 of those frequency channels to EchoStar in exchange for use of satellite capacity to carry its package of 36 religious-oriented television and radio channels.<sup>14</sup>

DBS services could also be provided in the Ka-band. While several companies have announced plans ultimately to develop such a service, none has launched a satellite, much less developed detailed plans to begin offering service.<sup>15</sup>

## **II. Proposed Merger and its review**

EchoStar and General Motors announced an agreement on October 28, 2001 under which EchoStar would acquire Hughes Electronics Corporation (Hughes), a subsidiary of General Motors.<sup>16</sup> Hughes is comprised of four main units: DirecTV, Inc. is the United States' leading provider of digital quality direct-to-home television entertainment programming; Hughes also provides DirecTV in Latin America through the DirecTV Latin America partnership; PanAmSat Corporation is the world's leading provider of commercial satellite services, operating a global fleet of 21 satellites— Hughes owns 81% of PanAmSat; and Hughes Network Systems is the world's leading supplier of satellite-based private business networks with a market share of more than 50%, is a leading producer of set-top receivers for DirecTV, and provides the DirecWAY satellite-based Internet access service.<sup>17</sup> Between its DirecTV and PanAmSat units,

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<sup>13</sup> *Id.*

<sup>14</sup> Dominion Video Satellite, Inc. Application for Minor Modification of Authority to Construct and Launch and to Continue Construction and Launch of Planned Satellite at 61.5° W.L., File No. 12-SAT-ML-97, *Order and Authorization*, DA 99-915, ¶ 3 (rel. May 17, 1999). See <http://www.skyangel.com/> for a description of Dominion's programming.

<sup>15</sup> See *R/L DBS Extension Order* ¶ 19 (noting that because of the high barriers to entry and long lead times for satellite deployment, "R/L DBS's planned service is perhaps the last opportunity in the near-term for entry by a competitive provider within the DBS service itself.").

<sup>16</sup> See Nikhil Deogun and Andy Pasztor, *GM Agrees to Sell Hughes to EchoStar – Deal Valued at \$25.8 Billion in Stock, Cash to Create Giant Satellite-TV Firm*, WALL ST. J., Oct. 29, 2001 at A3.

<sup>17</sup> See Hughes Electronics Corporation, at <http://www.hughes.com/ir/general/default.xml>.

Hughes holds licenses for 25 Ka- and 9 Ku-band orbital locations that can be used to provide DBS and other consumer satellite services.<sup>18</sup>

A. *Timing of review*

The parties filed for a transfer of licenses with the FCC on December 3, 2001, and the FCC initiated a merger review.<sup>19</sup> Currently, the FCC's review of the merger is scheduled to be completed by November 2, 2002, according to the FCC's informal merger review clock.<sup>20</sup> The Department of Justice review of the merger pursuant to the Hart-Scott-Rodino Act is not yet complete.

The review of the EchoStar and DirecTV merger has generated substantial commentary, both formal comments to the reviewing agencies and informal comments throughout the media. Expert opinions have been offered on, among other topics, the value of efficiency and other benefits of the proposed merger, whether the appropriate antitrust product markets should be broadly or narrowly defined, the relevant geographic markets, and the adequacy of proposed concessions by EchoStar—such as uniform national pricing. Different experts have different views on these matters.<sup>21</sup> Most commentators in the proceedings reviewing the merger claim the relevant market is some form of multichannel video programming distribution (MVPD) services, including DBS services, cable services, and potentially other less widely adopted services.<sup>22</sup>

B. *Claimed benefits of proposed merger*

The merging parties claim many benefits from the proposed merger. Some of these benefits are the usual potential savings from combining operations and the possibility of eliminating duplicative costs.

The most intriguing claim is that the merger will allow the new company to offer new satellite services, particularly local-into-local signals for all local broadcast stations,

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<sup>18</sup> Based on data available from [www.lyngsat.com](http://www.lyngsat.com), [www.directv.com](http://www.directv.com), [www.panamsat.com](http://www.panamsat.com), and FCC orders.

<sup>19</sup> Cable Services Bureau Action, *Public Notice*, DA 01-3005 (rel. Dec. 26, 2001).

<sup>20</sup> See Office of General Counsel, Transaction Team, Federal Communications Commission, at <http://www.fcc.gov/transaction/echostar-directv.html>.

<sup>21</sup> Compare Declaration of Dr. Robert D. Willig, CS Docket 01-348, at 25-33 (filed Feb. 25, 2002) (describing how New EchoStar would set its national price and how it would benefit consumers) with Declaration of J. Gregory Sidak, CS Docket 01-348, at 31-38 (filed Feb. 4, 2002); Declaration of Paul W. MacAvoy, CS Docket 01-348, at 52-55 (filed Feb. 4, 2002); Declaration of Daniel L. Rubinfeld, CS Docket 01-348, at 17-19 (filed Feb. 4, 2002) (each arguing that the national pricing proposed by New EchoStar would not improve consumer welfare).

<sup>22</sup> See, e.g., Willig Declaration at 39-41; Sidak Declaration at 8-9; Rubinfeld Declaration at 4. I have no strong views on the appropriate market definitions for the antitrust review of this merger. Underlying programming, whether for information or entertainment, is part of a complex differentiated product market. Availability of alternative information and entertainment outside of MVPD packages influences the demand for the packages. For example, my own research with R. Crandall and others found a significant effect from the presence of free over-the-air broadcast television signals on the demand for cable services (See R.W. Crandall and H.W. Furchtgott-Roth, *Cable TV: Regulation or Competition?* (Washington, DC: Brookings Institution), 1996.)

which neither company today separately can offer.<sup>23</sup> These efficiencies could be gained by placing new programming in spectrum that would become available after the elimination of redundant carriage of signals for programming currently carried by both DirecTV and EchoStar.<sup>24</sup> With cleared spectrum, EchoStar could use new compression technologies to offer more channels with new and varied programming services.<sup>25</sup>

The benefit from more efficient use of spectrum for EchoStar, however, can meaningfully be achieved only if current customers have no disruption of service. Customers for DirecTV and EchoStar have receiving equipment and set-top boxes that cannot usefully receive the other company's signal, much less signals based on a more efficient technology.<sup>26</sup> Spectrum that is currently used to provide programming services for either EchoStar or DirecTV cannot easily be cleared until customers change their existing equipment to new equipment consistent with the service offerings of the combined company. The transition of customer equipment and spectrum usage is a daunting task, and even EchoStar concedes that the full benefits of spectrum efficiency from a potential merger are years away.<sup>27</sup>

### **III. Possible antitrust objections to EchoStar-DirecTV merger**

Some commentators have argued that the proposed merger between EchoStar and DirecTV could be blocked by either the DoJ or the FCC and have stated a variety of reasons. Many reasons appear to be based on a lack of sufficient remaining competition in the relevant market and barriers to new entry into the market.

#### *A. Reduced competition in relevant market*

A central finding in a decision to block the proposed merger would likely be a lack of sufficient competition after the merger in a relevant antitrust market. Depending on how antitrust markets are defined, the change in the number of competitors as a result of the proposed merger between EchoStar and DirecTV would be from two to one, or

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<sup>23</sup> Opposition to Petitions to Deny and Reply Comments of EchoStar Communications Corporation and Hughes Electronics Corporation, CS Docket No. 01-348, at 3-20 (filed Feb. 25, 2002) ("EchoStar Reply").

<sup>24</sup> EchoStar Satellite Corporation and Hughes Electronics Corporation, Application for Authority to Launch and Operate New EchoStar 1 (USABSS-16), File No. SAT-LOA-20020225-00025, at 11 (filed Feb. 25, 2002) ("New EchoStar 1 Application").

<sup>25</sup> *Id.*

<sup>26</sup> EchoStar Reply at 29-30.

<sup>27</sup> EchoStar and Hughes suggest that the implementation of the merger's synergies will take some time. Their best hope is that the merged entity will be able to build, launch, and operate a new spot-beam satellite so that "the rollout can be completed as soon as 24 months" after regulatory approval of the merger. New EchoStar 1 Application at 2-3; EchoStar Satellite Corporation and Hughes Electronics Corporation, Application for Authority to Launch and Operate New EchoStar 1 (USABSS-16), CS Docket No. 01-348, Joint Opposition and Reply Comments at 3 (filed May 30, 2002). In the technical data submitted to the ITU for the New EchoStar 1 satellite application, EchoStar and Hughes indicate that New EchoStar 1 will not be brought into use until February 2005, suggesting an even longer implementation timetable. *Id.* at Exhibit 1, page 3. EchoStar and Hughes have submitted economic analysis to the FCC indicating that the merger's synergies will not be fully realized until 2007. See Ex Parte Presentation of EchoStar Communications Corporation and Hughes Electronics Corporation before the Federal Communications Commission, CS Docket No. 01-348 (filed Aug. 13, 2002).

from three to two, or from one small number to a smaller number.<sup>28</sup> None of the economic experts in the FCC proceeding specifically includes Rainbow DBS in these calculations, although it is not clear whether its exclusion follows from any limitation in its likely service offerings or from the timeliness of its market entry.

According to some commentators, the reduction in competition is particularly acute in rural areas where cable and other distributors of video programming are less common.<sup>29</sup> To the extent rural areas are a concern of the reviewing federal agencies, the reduction in the number of DBS providers may be critical.

*B. A lack of entry in MVPD markets*

The reduction in competition between the merging firms might pose less concern if other firms could freely enter. With entry into competitive cable services protected under the 1992 Cable Act, many businesses have developed plans to compete terrestrially with cable operators in the MVPD service market either through overbuilds, the use of phone company facilities, or other means. While some companies such as RCN have successfully overbuilt cable systems in selected local markets, relatively few areas today have competitive overbuilds, and fewer still have financially viable overbuilds.<sup>30</sup>

Some rural areas have no cable service at all, much less two or more providers.<sup>31</sup> Opportunities for entry of terrestrial services may be more limited in rural areas than opportunities for entry of satellite-based services.

Although many other firms have developed business plans to offer satellite-based MVPD services, entry has been slow for at least two different sets of reasons: barriers to entry to large-scale distribution of video programming generally; and barriers to entry specifically to provision of a DBS service.

*1. General barriers to entry to large-scale distribution of video programming*

Any business seeking to provide distribution of video services to consumers, either nationally or locally, faces the following substantial elements and costs of providing service:

- a. Contracts for programming
- b. Handling and distribution of programming from source to customer
- c. Available and compatible consumer equipment to view programming
- d. Retail sale of service to consumers
- e. Installation and maintenance services, if required
- f. Advertising
- g. Coordination of above

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<sup>28</sup> See, e.g., Declaration of J. Gregory Sidak, CS Docket 01-348, at 8-12 (filed Feb. 4, 2002).

<sup>29</sup> See *Id.* at 9; Declaration of Paul W. MacAvoy, CS Docket 01-348, at 47-55 (filed Feb. 4, 2002).

<sup>30</sup> Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, CS Docket No. 01-129, *Eighth Annual Report*, FCC 01-389, ¶¶ 107-12 (rel. Jan. 14, 2002).

<sup>31</sup> See, e.g., Petition to Deny by the National Rural Telecommunications Cooperative, CS Docket No. 01-348, at 5-20 (filed Feb. 5, 2002).

These seven factors limiting entry apply with equal force to DBS services, cable overbuild services, and many other means of distributing video services. Each of these factors has substantial fixed costs that might be viewed as a barrier to entry, particularly to a national distribution of video programming. These factors do not limit the specific volume of programming that can be distributed or the number of firms that can compete against one another; they merely impose a substantial cost on any firm seeking to enter the market.

Many large media companies, including Cablevision, have substantial experience and expertise in these seven factors. Relative to a business unfamiliar with such operations, a large media company would have a greater understanding of these factors, and quite likely a lower cost of offering a new service.

## 2. *Barriers to entry in satellite-based services*

Entering satellite-based services is substantially more difficult and time-consuming than merely entering terrestrial service markets. Two additional factors—government licenses for satellite-based services and the support of an operational satellite—pertain just to satellite services.

### a. Government licenses

Hundreds of satellites orbit the earth for a variety of commercial, telecommunications, scientific, meteorological, and military purposes. Of all commercial applications of satellite technologies, DBS services, offering a wide range of video programming to subscribers, have proven to be among the most successful. DBS takes advantage of substantial economies of scale; one satellite system can equally well serve 100 million customers as one customer. In the past 15 years, DBS services have become potentially accessible to the vast majority of households around the world.

Regardless of the extent of the demand, the supply of DBS services is limited by at least two constraining factors: available spectrum and the availability of satellite orbital positions at different locations above the earth. DBS services use substantial swaths of spectrum, both to transmit signals from the earth to the satellite, and to broadcast signals from the satellite to receivers in residential buildings on the earth. Because of the service's bandwidth demands and technical requirements to use small receiver antennae, DBS services are most appropriately offered today in the Ku- and Ka-bands. International arrangements through the International Telecommunications Union provide a practical limitation on the Ku-band orbital locations available to DBS providers. Under current international arrangements, the United States has only eight orbital locations assigned to it for the DBS service in the Ku-band.<sup>32</sup> Ka-band technology is relatively

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<sup>32</sup> These orbital locations are 61.5° W.L., 101° W.L., 110° W.L., 119° W.L., 148° W.L., 157° W.L., 166° W.L., and 175° W.L. Of these locations, 101° W.L., 110° W.L., and 119° W.L. are considered full-CONUS orbital locations because of their ability to cover the United States without difficulties. See National Association of Broadcasters and Association of Local Television Stations Request for

new and no provider has yet to provide DBS services in the United States from the Ka-band.

The proposed combined firm of EchoStar and Hughes would have control of all the full-CONUS Ku-band DBS orbital positions allocated to the United States.<sup>33</sup> In addition, the proposed merged firm would also have control over much of the Ka-band spectrum where DBS services technically could, but have yet to be, offered in the United States.<sup>34</sup>

b. Operational satellites

Even if a firm has a license to provide DBS services, actual provision of service may take years to commence, if ever. A DBS license is of little use without an operational satellite to provide a DBS service. EchoStar and DirecTV currently control all 15 of the satellites offering DBS services in the Ku-band. Satellites require years to design, construct, test, launch, and make operational. While several firms may have made tentative plans to ultimately offer DBS services, only one, Rainbow DBS, has received authorization to construct and launch a satellite for DBS service to U.S. households.<sup>35</sup>

#### **IV. A possible solution to any governmental objections to the proposed EchoStar-Hughes merger**

Government objections to the proposed EchoStar-Hughes merger would likely be based at least in part on the lack of remaining effective competition in the relevant antitrust market (presumably some form of an MVPD service market) and the difficulty of entry into the market. Both federal agencies are aware of the planned entry of Rainbow DBS as a potential competitor for DBS services; a decision to block the merger would be despite and not because of the planned launch of Rainbow DBS next year. At the same time, a combined EchoStar-Hughes firm would have many of the scarce assets—government licenses for DBS services and operational satellites—necessary for a viable entry strategy for a new DBS service.

If the government were to object to the merger, one solution to preserve the structure of the merger and any associated benefits would be for the merging parties to

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Modification of Broadcast Carriage Rules for Satellite Carriers, CSR-5865-Z, Declaratory Ruling and Order, DA 02-765, ¶ 6 (rel. Apr. 4, 2002).

<sup>33</sup> The only DBS licenses in the Ku-band that would not be controlled by a combined EchoStar-DirecTV would be those for a few channels held by Dominion and Cablevision at 61.5° W.L.

<sup>34</sup> Second Round Assignment of Geostationary Satellite Orbit Locations to Fixed Satellite Service Space Stations in the Ka-Band, *Order*, DA 01-1693 at Appendix A (rel. Aug. 3, 2001).

<sup>35</sup> Dominion, the only other entity with an authorization to provide DBS service, claims it has “contracted to construct two of its own DBS satellites.” *See* SkyAngel - Christian/Family-Friendly television and radio channels, at <http://www.messianicgarden.com/network/networks/skyangel.htm>. Dominion indicates, however, that it will continue to transmit from the EchoStar III DBS satellite for domestic U.S. DBS service while using Dominion's own DBS satellites for international DBS service. *Id.* Use of the EchoStar III satellite until its end-of-life would mean that Dominion would not become a facilities-based competitor until 2007 at the earliest.

sell or lease selected assets to a new and viable entrant. The assets that EchoStar and Hughes control that would be most difficult for another firm to replicate are their Ku-band licenses and associated operational satellites.

While many businesses could in theory enter in the MVPD market with enough assets spun off from EchoStar-Hughes, the potential entrant that would likely need the fewest additional assets to become a credible and viable full-fledged competitor is Cablevision. Cablevision already has a credible business plan to provide DBS services by the beginning of 2004 even without additional assets. A small number of additional DBS frequency channels would enable Cablevision to enhance the Rainbow DBS offering with more channel capacity and a more robust geographic reach. Leasing an operational EchoStar satellite or some of its capacity to Cablevision could give Cablevision greater geographic reach as well as a redundant satellite to enhance its system's fault tolerance.

Other businesses could also serve as a new entrant offering DBS services to compete with a newly merged EchoStar. Other potential entrants, however, either lack a credible capability to operate a satellite service or experience in offering a large-scale service distributing video programming—or both. Alternatively, a business could serve as a competitive surrogate by continuing operations with some or all of DirecTV's assets and customer base, but such an operation would undermine most if not all of the efficiency benefits associated with the merger. Only Cablevision, as a facilities-based entrant, appears positioned credibly to offer a competing service within any reasonable time period without eroding the basis for the merger.<sup>36</sup>

Moreover, with additional spectrum frequency channels and without an embedded base of incompatible customer equipment, Rainbow DBS might well be able to offer full-scale local-into-local service before an EchoStar-DirecTV merged firm could. The claimed benefits of an EchoStar-Hughes merger are the same benefits that would accrue to enhanced Rainbow DBS service offering, except that Rainbow DBS might be able to provide them to the market more quickly.

The stand-alone Rainbow DBS offering will likely attract the interests of some consumers, but may not attract enough consumers to provide a serious constraint on the ability of EchoStar-Hughes to set prices significantly above current levels. An enhanced Rainbow DBS service with more channels and greater geographic reach would be a more formidable competitor and would be more likely to limit any potential anticompetitive behavior by the proposed merged entity.

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<sup>36</sup> Less than two years ago, the Commission concluded that "R/L DBS's planned service is perhaps the last opportunity in the near-term for entry by a competitive provider within the DBS service itself." *See R/L DBS Extension Order* ¶ 19. No other entity has received an authorization since that time to construct or launch a satellite for DBS service.

Cablevision has circulated an informal document describing the possibilities of such a private transfer of assets from the merged EchoStar firm to Cablevision.<sup>37</sup> This document describes the transfer of 11 frequency channels from EchoStar to Cablevision as well as the three-year lease of a satellite at 61.5 W.L. In addition, the Cablevision proposal contemplates that Cablevision would sublease the 6 frequency channels that EchoStar currently leases from Dominion.<sup>38</sup> Of course, many other private transfers from EchoStar or DirecTV to Cablevision might result in a Rainbow DBS offering equally or more competitive than the one described in the Cablevision proposal.

## **V. Merger with a private transfer of assets may be better than no merger**

Consumers value various characteristics of video programming offerings: variety, visual quality, and programming targeted to specific local, regional, or demographic interests. Consumers currently have available from a DBS provider a wide range of standard-definition cable channels, local broadcast signals in only the largest designated market areas (DMAs), and few if any purely high-definition video signals. The video offerings on DBS are similar to those available on a local cable system although, particularly in smaller DMAs, a cable operator is likely to have more local broadcast channels.

From a consumer's perspective, the current market structure, even with the entry of Rainbow DBS, may be inferior to a merged EchoStar-DirecTV with additional spectrum slots obtained by Rainbow DBS. Under a merger of EchoStar and DirecTV with a transfer of significant DBS frequency channels and a leasing of satellite capacity to Cablevision, the number of nationwide DBS full-fledged competitors would remain at the current two. Moreover, DBS consumers would have access to all programming currently offered, plus ultimately the following: two different sources of local broadcast signals in all DMAs, new high-definition programming channels, as well as new standard-definition video channels aimed at targeted audiences. Paradoxically, many of the new video programming offerings would likely come first from the new entrant DBS operator with fewer DBS frequency channels, Rainbow DBS, because all of its customers could use new equipment to receive more technologically advanced signals.

## **VI. Conclusion**

If the federal agencies reviewing the proposed EchoStar-Hughes merger were prepared to block it based on antitrust concerns, a private transaction could remedy those concerns. The net result of a limited transfer of assets from EchoStar-Hughes to Cablevision would be a substantial potential welfare improvement for the American consumer. The transfer of satellite-related assets would not affect the ability of cable operators and other terrestrial providers to offer video services. Where today two major

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<sup>37</sup> Ex Parte Presentation of R/L DBS Company, LLC before the Federal Communications Commission, Sept. 18, 2002.

<sup>38</sup> Other private contracts may be available that allow Cablevision to address the geographic-reach issue.

operators compete to provide DBS services, so too in the not-too-distant future would two newly constituted carriers compete to provide DBS services. The new carriers would be substantially more technologically capable than either carrier today. Each would eventually be capable of providing local-into-local broadcast services as well as offering a range of high and single-definition video programming services unavailable today.

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