

of the merged firm to compete with the number one firm.<sup>305</sup> Noting the district court's finding that "there had been no significant entries in the baby-food market in decades and that new entry was 'difficult and improbable,'" the court of appeals stated that "[a]s far as we can determine, no court has ever approved a merger to duopoly under similar circumstances."<sup>306</sup>

101. In *FTC v. Staples*, the district court enjoined the merger of two competing office supply superstores where the merger would have left only one superstore competitor in 15 metropolitan areas and only two competing superstores in 27 other areas.<sup>307</sup> Specifically noting the markets where the merger would result in monopoly, the court concluded that the "direct evidence shows that by eliminating Staples' most significant, and in many markets only, rival, this merger would allow Staples to increase prices or otherwise maintain prices at an anticompetitive level."<sup>308</sup> Likewise, in *Franklin Electric Co.*, the district court enjoined a joint venture involving the only two domestic producers of submersible turbine pumps, where there were no foreign manufacturers with competitive products and numerous barriers to entry were present.<sup>309</sup>

102. Finally, where a merger is likely to result in a significant reduction in the number of competitors and a substantial increase in concentration, antitrust authorities generally require the parties to demonstrate that there exist countervailing, extraordinarily large, cognizable, and non-speculative efficiencies that are likely to result from the merger. For example, the *DOJ/FTC Merger Guidelines* state that "[w]hen the potential adverse competitive effect of a merger is likely to be particularly large, extraordinarily great cognizable efficiencies would be necessary to prevent the merger from being anticompetitive."<sup>310</sup> The Guidelines go on to state that "[e]fficiencies almost never justify a merger to monopoly or near-monopoly."<sup>311</sup> Similarly, in the *Heinz* decision, the court of appeals stated:

[H]igh market concentration levels . . . require, in rebuttal, proof of extraordinary efficiencies. . . . Moreover, given the high concentration levels, the court must undertake a rigorous analysis of the kinds of efficiencies being urged by the parties in order to ensure that those 'efficiencies' represent more than mere speculation and promises about post-merger behavior."<sup>312</sup>

103. More generally, Professors Areeda, Hovenkamp and Solow, in their authoritative antitrust treatise, observe that mergers that significantly increase concentration in already highly concentrated industries "should carry a strong presumption of illegality that can be defeated only by a

<sup>305</sup> *FTC v. H.J. Heinz Co.*, 246 F.3d 708 (D.C. Cir. 2001).

<sup>306</sup> *Id.* at 717.

<sup>307</sup> *FTC v. Staples*, 970 F. Supp. 1066, 1081 (D.D.C. 1997)

<sup>308</sup> *Id.* at 1082. See also *FTC v. Swedish Match*, 131 F. Supp. 2d 151 (D.D.C. 2000) (enjoining proposed merger of first and third largest producers of loose-leaf tobacco).

<sup>309</sup> *United States v. Franklin Elec. Co.*, 130 F. Supp. 2d 1025 (W.D. Wis. 2000). Cf. IV PHILLIP E. AREEDA, HERBERT HOVENKAMP & JOHN L. SOLOW, *ANTITRUST LAW* ¶ 911 at 54-55 (Rev. ed. 1998) ("no merger threatens to injure competition more than one that immediately changes a market from competitive to monopolized.")

<sup>310</sup> Horizontal Merger Guidelines, issued by the U.S. Department of Justice & Federal Trade Commission, April 2, 1992, revised April 8, 1997 ("*DOJ/FTC Guidelines*"). § 4.

<sup>311</sup> *Id.*

<sup>312</sup> *Heinz*, 246 F.3d at 720-21. See also *Swedish Match*, 131 F. Supp. 2d at 171 (finding, with respect to proposed merger of first and third largest manufacturers of loose-leaf tobacco, that the efficiency defense is "inappropriate in this particular case, in which the acquisition would generate undue market share and increase concentration").

showing of extraordinarily easy entry or truly extraordinary efficiencies. . . .<sup>313</sup> Thus, existing antitrust doctrine suggests that a merger to duopoly or monopoly faces a strong presumption of illegality. Moreover, where a proposed merger would result in a significant increase in concentration in an already concentrated market, parties advocating the merger will be required to demonstrate that claimed efficiencies are particularly large, cognizable and non-speculative.

## B. Potential Competitive Harms – MVPD Market

104. In this section, we examine the potential competitive effects of the merger in the relevant markets that include DBS services. We find, based on the record evidence, that there is a significant likelihood that the proposed merger will substantially increase concentration in an already concentrated market, substantially reduce competition and harm consumers.

### 1. Structural Factors Affecting Likelihood of Competitive Harms

105. Consistent with the *DOJ/FTC Guidelines* and Commission precedent, we first perform a structural analysis of the merger to examine if it would create conditions conducive to anticompetitive behavior.<sup>314</sup> We begin with an analysis of the relevant product and geographic markets. We next identify market participants, examine market concentration and how concentration will change as a result of the merger, and consider whether entry Conditions are sufficiently easy that new competitors could likely defeat any attempted post-merger price increase.

#### a. The Relevant Product Market

106. Under our analytical framework and the principles established by the *DOJ/FTC Guidelines*, our first step in analyzing a proposed merger is to define the relevant product and geographic markets. The *Guidelines* define the relevant product market as the smallest group of competing products for which a hypothetical monopoly provider of the products would profitably impose at least a “small but significant and non-transitory price increase,” presuming no change in the terms of sale of other products.<sup>315</sup> In other words, when one product is a reasonable substitute for the other in the eyes of consumers, it is to be included in the relevant product market even though the products themselves are not identical. Thus, the relevant product market includes “all products ‘reasonably interchangeable by consumers for the same purposes.’”<sup>316</sup>

107. The parties in this proceeding disagree as to the exact boundaries of the relevant product market that includes DBS service, though all appear to agree that it includes video programming services provided by at least some identifiable subset of MVPDs. The Applicants submit that the relevant product market in this case is “no narrower than the MVPD market, and may be broader than that.”<sup>317</sup> The Applicants’ expert witness, Dr. Willig, states that the MVPD market includes cable and DBS services. In

<sup>313</sup> IV AREEDA ¶932 at 160.

<sup>314</sup> Structural merger analysis, as the name suggests, considers structural characteristics of the merging firms and the relevant markets to make predictions about the likely competitive effects of a proposed merger.

<sup>315</sup> *DOJ/FTC Guidelines* §§ 1.11, 1.12.

<sup>316</sup> *Unired Sraes v. E.I. du Pont de Nemours & Co.* 351 U.S. 377, 395 (1956) (The relevant product market is composed of products that have reasonable interchangeability); see also *Unired Sraes v. Microsoft*, 253 F.3d 34, 52 (D.C. Cir. 2001), cert. denied, 122 S. Ct. 350 (2001) (in determining reasonable substitutes, the court excluded “middleware” software from the definition of the relevant product market because of its present non-interchangeability with Windows notwithstanding its long-term future potential).

<sup>317</sup> Application. Willig Decl. at 4

addition, Dr. Willig notes that other available MVPD services include home satellite dishes (“HSD or “C-Band”), multichannel multipoint distribution service (“MMDS”), and private cable or satellite master antenna television (“SMATV”) systems.<sup>318</sup> Dr. Willig also asserts that the market in which DBS providers compete with cable operators may be expanding to include DSL providers, incumbent phone companies, and cellular phone providers, “as bundled packages with digital television, high speed Internet access, and video-on-demand become relatively more important in the MVPD market.”<sup>319</sup>

108. Although some merger Opponents and others agree that the relevant product market is MVPD services,<sup>320</sup> most contend that the relevant product market is narrower and includes only cable and DBS services.<sup>321</sup> Moreover, several distinguish between low-capacity and high-capacity cable services, and argue that only the latter is a viable substitute for DBS.<sup>322</sup> These merger Opponents assert that many low-capacity cable systems fail to offer the channel capacity, programming choices, and additional services, such as pay-per-view movies and interactive television, required to compete effectively with DBS.<sup>323</sup> NRTC’s expert, Dr. MacAvoy, suggests that analog cable systems, which generally have fewer channels and poorer quality, do not “discipline the pricing of high-capacity cable and/or DBS service.”<sup>324</sup> Moreover, others claim that more than 8,000 low-capacity cable systems, serving 8.2 million subscribers, primarily in rural areas, are at risk of business failure in the next five years,<sup>325</sup> a risk that they claim will be greatly exacerbated by the proposed merger. NAB and Pegasus claim that SMATV and C-Band should not be included in the relevant product market because the market shares of these services are declining, and because consumers do not perceive these services to be good substitutes for DBS.<sup>326</sup>

109. At the outset we recognize that, in the *Video Competition Report*,<sup>327</sup> we have defined a relevant product market as “multichannel video programming service,” provided by MVPDs.<sup>328</sup> While such a market definition may be appropriate in considering competitive services that are sufficiently

<sup>318</sup> *Id.* at n. 1.

<sup>319</sup> *Id.* at 10-11

<sup>320</sup> ACC Comments at 4; AAI Comments at 2

<sup>321</sup> *Id.*; Circuit City Comments at 2; Intelsat Comments at 4 -5, Pegasus Petition at 14.

<sup>322</sup> See, e.g., NRTC Petition at 20; Consumers Union Comments at 6-8. Frequently Commenters use the label “analog” to denote low capacity systems and “digital” to denote high capacity systems.

<sup>323</sup> NRTC Petition at 20.

<sup>324</sup> *Id.*, MacAvoy Decl. at 6.

<sup>325</sup> *Id.* at 22. ACA Petition at 8-10. ACA suggests that New EchoStar will use its market power to eliminate independent cable competitors. *Id.*

<sup>326</sup> NAB Petition, Sidak Decl. at 8 and Pegasus Petition, Ruhinfeld Aff. at 9.

<sup>327</sup> *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 17 FCC Record I244 (2002) (“*Video Competition Report*”).

<sup>328</sup> See, e.g., *Implementation of Section 19 of the Cable Television Consumer Protection and Competition Act of 1992*, First Report, 9 FCC Rcd 7442, 7461 (1994) (“For purposes of this Report, the relevant product market contemplated in the 1992 Act – multichannel video programming service – is the appropriate starting point for assessing the status of competition in the market for delivery of video programming. A primary focus of this Report, and a central concern of the 1992 Cable Act, is the extent to which MVPDs that use alternative technologies are emerging as significant competitors to cable operators.”).

substitutable so as to constrain the ability of cable companies to raise price? this market definition may not be appropriate for evaluating the competitive effects of a merger between two DBS providers. In particular, in defining the relevant product market for merger analysis, one starts with the products supplied by the merging firms and ask whether a monopolist, supplying those products, would profitably impose "a small but significant and non-transitory price increase." If the monopolist would not be able to impose such a price increase, then one adds in the next closest substitute to the products of the merging firms and repeats the experiment." The relevant product that results from this procedure depends significantly on the products with which one started. Thus, since the *Video Competition Report* starts with cable services in defining the relevant product market, while in this proceeding, we must start with the products of the merging firms – *i.e.*, DBS service – it is entirely possible that we might derive different relevant product markets, given the different starting points. For example, customers of low capacity cable systems might find DBS service to be sufficiently attractive that they would switch from cable to DBS if the low capacity cable system attempted to raise its price. On the other hand, customers of DBS service might find the low capacity cable systems to be sufficiently inferior to DBS service that they would not switch to cable in response to a DBS price increase. Thus, while DBS would constrain price increases by low capacity cable systems, low capacity cable systems might not be able to constrain price increases by DBS providers."

110. The evidence in the record is sufficient for us to draw several conclusions. First, the evidence is clear that the relevant product market that includes DBS services involves differentiated products." While all MVPDs transmit video programming networks to customers for a fee, there are clear, and significant, differences in the specific product characteristics of the service bundles offered by different MVPDs and between service bundles offered by the same MVPD. This product differentiation, combined with the fact that EchoStar and DirecTV appear to be closer substitutes for each other than for services of cable systems *or* other MVPDs means that the unilateral incentive to raise prices after the merger is likely to be a significant problem.

111. Thus, although both cable and DBS operators typically offer several packages of services, some of which may include premium movie channels (*e.g.*, HBO and Cinemax) and pay-per-view movies, cable operators and DBS providers frequently differ in the specific characteristics of the service packages and in the total number of channels of programming that they offer. For example, EchoStar and DirecTV both have the capacity to offer as many as 300 channels, while many cable operators have much lower channel capacity, in some cases fewer than 30 channels." In this case, the proposed merger eliminates the closest competitor and so removes the most effective source of price discipline.

<sup>319</sup> See, *e.g.*, *id.* at 1462 (For purposes of this Report, the Commission draws upon the relevant market concept in order to identify those distribution technologies that will potentially have a constraining effect on cable operator conduct.).

<sup>130</sup> Gregory J. Werden, *The 1992 Merger Guidelines and the Ascent of the Hypothetical Monopolist Paradigm*, at <http://www.usdoj.gov/atr/hmerger/11256.htm> (visited Sept. 20, 2002). This approach has been referred to as the "smallest market principle."

<sup>331</sup> Under this example, in evaluating a merger of two cable companies, DBS would be included within the relevant product market, but in evaluating the merger of two DBS providers, the relevant market would not include low capacity cable systems.

<sup>332</sup> Differentiated products are products whose characteristics differ and which are viewed as imperfect substitutes by consumers. See Dennis W. Carlton & Jeffrey M. Perloff, *MODERN INDUSTRIAL ORGANIZATION* 281 (2d ed. 1991).

<sup>333</sup> Seventy-two percent of cable systems have less than 53 channels. These low-capacity systems serve 24% of cable subscribers in the U.S. according to Warren Communications News' Data by Design.

112. Second, the evidence in the record suggests that high-capacity cable systems are a closer substitute for DBS service than low-capacity cable systems.”<sup>334</sup> For example, staff analysis of chum data supplied by the Applicants indicates a statistically significant higher chum rates from DirecTV to EchoStar in areas with low-capacity cable systems compared to areas with high capacity cable systems.<sup>335</sup> In addition **DBS** has significantly higher market penetration in areas served by low capacity cable systems than in areas served by high capacity cable systems.<sup>336</sup> Again, this suggests that the merged entity is likely to have a greater incentive and ability to raise price after the merger in areas served by low-capacity cable systems than it would in areas served by high-capacity cable systems.

113. Third, as discussed in greater detail below, the evidence in the record strongly indicates that the services offered by the Applicants are closer substitutes to each other than are cable services offered by either high-capacity or low-capacity cable systems. Moreover, the evidence further suggests that each of the Applicants views the other as its closest

114. Although the record strongly suggests that the relevant product market is considerably more narrow than all MVPD services, we are unable to conclusively define the relevant product market at this time. To conclusively resolve this issue, we would need additional evidence, either in the **form** of econometric demand analyses or other evidence of substitutability. It is, however, necessary to adopt a tentative relevant product market in order to proceed with the structural analysis.

115. For purposes of this analysis, will adopt the Applicants’ proposal of an MVPD product market. We recognize that this proposed market definition is the broadest of any proposed in the record, and because of this, it will tend to *minimize* any anticompetitive effects predicted by a structural analysis. Based on the evidence in the record, we find that the relevant product market that includes DBS is no

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<sup>334</sup> There are alternative ways that one could distinguish between high-capacity and low-capacity cable systems. Some of the commenters distinguish between analog and digital systems, though their comments appear to focus on the number of channels and other services that can be provided over a particular cable system. Since digital cable systems do not necessarily have the capacity to offer more channels, we find that this is not the best way to distinguish low-capacity systems from high-capacity systems. Another way to distinguish low-capacity system from high-capacity systems is to classify cable systems based on the maximum number of video channels that they can offer. Under this approach one might define low-capacity systems as having a maximum capacity of less than 53 channels and a high capacity system as having a capacity of 53 or more channels. Unfortunately, the evidence in the record is not sufficient to determine which definitional approach is more meaningful economically or where to draw the line between low-capacity and high-capacity systems. This is one of the many issues that will have to be referred to, and resolved at, the hearing.

<sup>335</sup> Letter from Applicants to Marlene Donch, Secretary, FCC, Attachment (“churn1201data.zip”), transmitted by letter from the Applicants to Marlene Dortch (July 12, 2002) and Letter from Applicants to Marlene Dortch, Secretary, FCC, Attachment (“monthly\_zip\_code\_data.zip”), transmitted by letter from Applicants to Marlene H. Donch, Secretary, FCC (July 25, 2002).

<sup>336</sup> In addition, analysis of the merger simulation model submitted by the Applicants suggests that low capacity cable systems do not pass the Merger Guidelines “smallest relevant market test.”

<sup>337</sup> **REDACTED**. In this Order, “**REDACTED**” indicates confidential or proprietary information, or analysis based on such information, submitted pursuant to the First and/or Second Protective Orders. See *EchoStar Communications Corporation, General Motors Corporation, and Hughes Electronics, Order Adopting Protective Order*, DA 02-27 (rel. Jan. 9, 2002); *EchoStar Communications Corporation, General Motors Corporation, and Hughes Electronics, Order Adopting Second Protective Order*, DA 02-964 (rel. Apr. 25, 2002). The unredacted version of this Order is available upon request only to those parties who have executed and filed with the Commission signed acknowledgements of the Second Protective Order. Qualified representatives, including those designated as parties to the hearing (see para. 297 *infra*) who have not yet signed the required acknowledgement may do so in order to obtain the unredacted Order.

broader than the entire MVPD market, but may well be narrower. In fact, the relevant product market may be limited to just DBS services. **as** EchoStar itself argued in its antitrust lawsuit against DirecTV.<sup>338</sup> We refer to hearing the question whether the relevant product market is in fact all MVPD services, or is a smaller subset of MVPD services. For example, the administrative **law** judge will consider whether the relevant product market includes services provided by all cable companies, or just by high-capacity cable systems, or neither.

116. **As** noted, **because** we are tentatively adopting such a broad product market definition, our structural analysis may underestimate potential competitive harms.” Nevertheless, even adopting the Applicants market definition, we find, as discussed below, that the structural characteristics suggest that the merger is likely to result in significant anticompetitive effects.

### b. The Relevant Geographic Markets

117. DOJ identifies a relevant geographic market as the region where a hypothetical monopolist that is the only producer of the relevant product in the region would profitably impose at least a “small but significant and nontransitory” increase in the price of the relevant product, assuming that the prices of all products provided elsewhere do not change.” This approach is consistent with the Supreme Court’s definition of the relevant geographic market as the region “in which the seller operates, and to which the purchaser can practicably turn for supplies.””

118. The Applicants contend that the relevant geographic market **is** national in scope, because both Applicants have national pricing plans for monthly subscription and programming fees.<sup>342</sup> Several merger Opponents and others disagree. They contend that the relevant market is local because the competitive alternatives available to consumers differ substantially across cable franchise areas. In particular, cable prices, service offerings, and installation charges vary across franchise areas.<sup>343</sup> **NAB** identifies the Designated Market Area (“**DMA**”) as the relevant geographic market, on the ground that cable operators distribute programming through their local franchises and consumers can only receive programming from sources available in their local area.<sup>344</sup> Pegasus and NRTC, in contrast, claim that the relevant geographic market is the local cable franchise area, because that is the area in which consumers have similar choices regarding a defined set of services.<sup>345</sup>

<sup>338</sup> Amended Complaint, *EchoStar Communications Corp. v. DirecTV Entertainment Corp.*, No. 00-I-212 (D. Colo. 2000).

<sup>339</sup> Because market definition plays such a critical role in structural merger analysis, plaintiffs typically try to define the narrowest possible relevant markets, while defendants favor the broadest possible market. See, e.g., Gregory J. Werden, *Simulating the Effects of Differentiated Products Mergers: A Practical Alternative to Structural Merger Policy*, 5 GEO. MASON L. REV. 363,369(1997)

<sup>340</sup> *DOJ/FTC Merger Guidelines* § 1.21.

<sup>341</sup> *Unired Sraes v. Grinnell Corp.*, 384 U.S. 563, 588-89 (1966); see also *FTC v. Elders Grain, Inc.*, 868 F.2d 901 (7<sup>th</sup> Cir. 1989).

<sup>342</sup> Application, Willig Decl. at 11.

<sup>343</sup> NAB Petition at 34-35. Pegasus Petition at 14; Duke Law Reply Comments at 12. In addition, NAB contends that the variation in EchoStar’s service offerings across local areas undermines its claim of a national geographic market. NAB Petition, **Sidak** Decl. at 10.

<sup>344</sup> NAB Petition at 34, **Sidak** Decl. at 12

<sup>345</sup> Pegasus Petition at 14; Rubinfeld Decl. at 10; NRTC Petition, MacAvoy Decl. at 7, 9.

119. Consistent with past practice and the record before us, we conclude that the relevant geographic market for MVPD service is local.<sup>346</sup> Although the Applicants offer service nationwide, consumers make decisions based on the MVPD choices available to them at their residences. Technically, the relevant geographic market, therefore, is the residence of each customer, since it would be prohibitively expensive for a customer to change his residence to avoid a “small but significant and nontransitory” increase in the price of MVPD service. Because it would be administratively impractical and inefficient to analyze a separate relevant geographic market for each individual customer, however, we will aggregate relevant geographic markets in which customers face similar competitive choices.” Consistent with our precedents in this area, we thus conclude that the relevant geographic market should be presumed to be the franchise area of a local cable operator, since customers within that franchise area have the choice between the incumbent franchised cable company and the two **DBS** providers.<sup>348</sup>

120. To further simplify the analysis, it appears reasonable to aggregate relevant geographic markets that exhibit similar competitive conditions. In particular, we find it reasonable to classify relevant geographic markets into three broad categories: (1) markets not served by any cable system; (2) markets served by a low-capacity cable system; and (3) markets served by high-capacity cable systems.<sup>349</sup>

<sup>346</sup> See, e.g., *AT&T-TCI Order*, 14 FCC Rcd at 3160,3112; *Time Warner-AOL Order*, 16 FCC Rcd at 6553.

<sup>347</sup> See *Bell Atlantic-NYNEX Order*, 12 FCC Rcd at 19985; *AT&T-MediaOne Order*, 15 FCC Rcd at 20016-17.

<sup>348</sup> We recognize that competitive choices may not be identical throughout the franchise area. For instance, the local cable operator may not offer service to all households. Moreover, cable overbuilders and SMATV providers may offer service only to selected areas within the local cable franchise area. Thus, to be rigorous we would need to define a separate and narrower relevant geographic market wherever cable does not actually provide service, and a separate relevant geographic market wherever other MVPDs, such as overbuilders, do provide service. As a practical matter, however, we do not believe such precision is necessary for purposes of our analysis. In particular, we note that there are only approximately 64 cable systems that have overbuilders and 129 cable systems that have a wireless cable provider out of a total of 9661 cable systems Warren Communications News, Inc., Data-by-Design. Moreover, even in the few cable franchise areas where there is an overbuilder, that overbuilder will generally not serve the entire cable franchise area. Thus, although overbuilders provide significant and effective competition to local cable operators in those areas in which they operate, the scope of their operations is geographically limited and likely to provide less competitive discipline on the prices of the DBS services, with their national footprint. See *Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992, Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment*, 17 FCC Rcd (2002). See also, e.g., *Time Warner Entertainment-Advance/Newhouse Partnership, d/b/a Time Warner Company, Petition for Deretermination of Effective Competition in Conway, South Carolina (CUID No. SC0023)*, 15 FCC Rcd 9540 (CSB 2000); *Time Warner Cable, Petition for Deretermination of Effective Competition, Atlanta, Georgia*, 15 CC Rcd 10808 (CSB 2000); *Falcon Cable Systems Company II, L.P. d/b/a Charrer Communications, Petition for Deretermination of Effective Competition in Various California Communities*, DA 02-2442 (MB, rel. Sept. 30, 2002); *Marcus Cable Associates, LLC d/b/a Charrer Communications, Petition for Deretermination of Effective Competition in Various Wisconsin Communities*, DA 02-2424 (MB, rel. Sept. 30, 2002).

<sup>349</sup> As discussed above, we find it reasonable to distinguish between low-capacity cable systems that offer relatively few channels and high capacity systems that offer many more channels, since we find that the latter are closer substitutes to DBS service than the former. We note that distinguishing between high-capacity and low capacity cable systems is consistent with the arguments of those commenters who contend that DBS faces significantly less competition from cable in areas served by analog cable systems than in areas served by digital cable systems. NRTC Petition at 20 (and MacAvoy Declaration at 6); Pegasus Petition at 19-20; Consumers Union Comments at 6-8, NAB Petition at 48. For example, NRTC’s expert, Dr. MacAvoy, suggests that analog cable systems, which generally have fewer channels and poorer quality, do not “discipline the pricing of digital cable and/or DBS service.” MacAvoy Decl. at 6. Similarly, NAB claims that New EchoStar will have the incentive and power to raise prices and reduce service quality in areas served by analog cable systems. NAB Petition at 58. In addition, as previously indicated, staff analysis of churn data submitted by the applicants show that there is a statistically significant

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121. As discussed below, the welfare effects on consumers may vary among the three categories of relevant geographic markets that we have identified. In particular, if the proposed merger appears likely to generate anticompetitive unilateral effects, the magnitude of those effects will increase, other things being equal, as the degree of substitutability between DBS and the incumbent cable company decreases in a particular relevant geographic market. Moreover, if the merged entity sets a single nationwide price, the price level it sets will depend not only on the elasticities of demand in the three types of markets, but also on the relative proportion of total households that each category represents.<sup>350</sup> Thus, it is critical to determine the number of consumers, or households, that reside in each of the three relevant geographic markets.

122. Unfortunately, the evidence concerning the precise number of households that fall into each of the three categories is conflicting. For example, the Applicants and Opponents disagree on the total number of consumers that do not have access to cable service. The Applicants claim that over 96% of all television households in the United States are passed by cable.<sup>351</sup> In addition, they contend that the total number of homes not passed by cable is irrelevant because in the course of their business they cannot isolate homes not passed by cable for discriminatory treatment.”

123. Opponents, on the other hand, contend that the number of homes not passed by cable is relevant to the analysis of the likely competitive effects of the merger and that the Applicants underestimate the number of households not passed by cable. NAB cites DirecTV’s internal data showing that three million, or 29%, of its approximately ten million subscribers have no access to cable.<sup>353</sup> Assuming that a similar percentage of EchoStar’s customers lack access to cable (approximately two million), NAB estimates that over five million DBS subscribers have no cable access.<sup>354</sup> Citing data compiled by the Department of Commerce’s National Telecommunications and Information Administration (“NTIA”) and the Department of Agriculture’s Rural Utilities Service, NRTC and NRECA claim that cable only passes approximately 81% of U.S. housing units, or alternatively that 23 million housing units are not passed by cable.<sup>355</sup>

124. Our estimate of the relative welfare losses resulting from the proposed merger depends on the relative percentage of households in each of the three categories of markets, since the incentive and ability of the merged firm to raise price after the merger is likely to vary among the three areas. Unfortunately, we find that the evidence in the record is inadequate to develop a reliable estimate of the number of homes that do not have access to cable. More specifically, Warren Communications, which publishes data on the number of homes passed by cable, does not clearly define what it means by “homes passed by cable.” Accordingly, it is not clear what data should be used to develop an estimate of “total homes.” Depending on the data set used to estimate total homes, the number of homes not passed by

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difference in churn rates for cable systems having less than 53 channels and those having more than 53 channels, see Appendix E.

<sup>350</sup> As the Applicants’ expert, Dr. Willig, points out, the profit-maximizing uniform price-cost margin is inversely related to the weighted average own-price elasticity of demand, where the weights are the share of DBS customers in each market. Applicants’ Reply Comments, Willig Declaration at 27.

<sup>351</sup> Application at 39

<sup>352</sup> *Id.* at 60.

<sup>353</sup> NAB Petition at 47

<sup>354</sup> *Id.*

<sup>355</sup> NRTC Petition, at 8-14; NRECA Comments at 4-5.

cable may vary from the 4% claimed by the Applicants to 21.28%.<sup>356</sup> Thus, the issue of the number of households not passed by cable will have *to be determined at hearing*.

125. In summary, we conclude that the relevant geographic market is local, and that it is reasonable to aggregate the relevant geographic markets into three broad categories of (1) markets not served by and cable operator; (2) markets served by low-capacity cable systems; and (3) markets served by high-capacity cable systems. We refer to hearing the issue of the number of households in each of the three categories of relevant geographic markets.

### C Market Participants

126. *Next* we identify market participants in the relevant markets. We include as market participants not only the firms that currently participate in the relevant markets,” but also any “uncommitted entrants” (i.e., firms that are likely to enter the relevant markets “within one year and without expending significant sunk costs of entry and exit in response to a small but significant and non-transitory increase in price.”)

127. As discussed below, the record indicates that the primary providers of MVPD services in the vast majority of relevant local markets are the two DBS operators and cable operators. As previously indicated the Applicants, who are the two primary providers of DBS service, each provide service nationwide. In the vast majority of areas in which cable service is available, there is a single, franchised cable provider. Thus, in areas where cable is available, the three main competitors are the franchised cable provider and the two DBS operators, while in areas where cable is unavailable, the only two major competitors are the Applicants themselves.

128. We recognize that there are other, smaller DBS providers, such as NRTC members (including Pegasus), which have exclusive agreements to resell DirecTV service within their service territories, and Dominion Video Satellite, Inc., which is a licensee of eight transponders at 61.5” W.L. Currently, Dominion leases six of its transponders to EchoStar and has an agreement to lease satellite capacity from EchoStar to transmit religious programming to customers. We do not find these providers would exert a significant competitive constraint on the merged entity. NRTC members do not pose a significant competitive threat because they act as resellers of DirecTV’s programming and therefore are unlikely to exert any significant price discipline on the merged entity, at least in the longer run.

<sup>356</sup>As NAB and NRTC point out, there are three different measures that could be used in developing an estimate of the total number of U.S. homes: (1) housing units (as defined by the Census); (2) occupied housing units (or households) (again as defined by the Census); and (3) television households (as defined by the A.C. Nielsen Company). Unfortunately, these three measures yield widely different estimates for the number of homes that do not have access to cable. The differences in resulting estimates can be seen as follows. Warren Communications News’ TELEVISION AND CABLE FACTBOOK reports that, as of year-end 2001, cable systems passed approximately 90,772,025 homes. According to Census 2000 data, there were approximately 115,904,641 housing units in the United States in the year 2000, and approximately 105,480,101 occupied housing units, or households, see U.S. CENSUS BUREAU, U.S. SUMMARY 2000 2 (July 2002). When measured against the Warren data on homes passed, we find that approximately 24,668,135 housing units, or 21.28%, are not passed by cable, and approximately 13,789,834 occupied housing units, or 13.07%, are not passed by cable. Finally, A.C. Nielsen Company reports that there were approximately 102,184,810 television households as of year-end 2001. Compared to cable homes passed, approximately 10,075,153 television households, or 9.86%, are not passed by cable. Thus, by these measures, the number of homes not passed by cable can vary from 9.86% to 21.28% depending on the data used in the comparison.

<sup>357</sup>DOJ/FTC Guidelines § 1.3

<sup>358</sup>*Id.* § 1.32. We will discuss “committed entrants,” also known as “potential entrants,” *infra*.

Moreover, NRTC argues that the merged entity will have the incentive to terminate the existing contract. Dominion, on the other hand, does not appear to pose a significant threat because it is not a facilities-based competitor, at this time, and only offers special interest programming.

129. In addition, under the Applicants' proposed market definition, which we have tentatively adopted, other MVPD providers, including MMDS, SMATV, open video systems, direct-to-home analog and digital satellite offerings, and cable overbuilders would **also be included as market participants**.<sup>359</sup> We agree with the Applicants that these other MVPD providers offer multichannel video programming services. We further agree that these other MVPDs compete in at least some relevant geographic markets. At the same time, however, it is not certain whether the services offered by these MVPDs will ultimately be found to fall within the relevant market that includes DBS service.

130. More importantly, the record suggests that, even if these MVPDs provide services that fall within the relevant product market, these other MVPDs are not a significant competitive presence in the vast majority of relevant geographic markets. The majority of these other MVPD providers serve only a relatively few local geographic areas and have little or no impact on relevant customer alternatives in the majority of markets. For example, in a limited number of franchise areas, an overbuilder or MMDS operator also offers service. Overbuilders offer service only in limited areas, however, and the growth of overbuilding has slowed substantially in recent years.<sup>360</sup> Similarly, MMDS operators also offer service only in limited areas. Furthermore, many MMDS license holders have shifted focus toward providing data transmission services rather than video services.<sup>361</sup> SMATV providers, which can offer service in any setting in which a public right-of-way is not crossed, tend to focus on providing service to high-density multi-dwelling units, and generally do not provide competition throughout a local franchise area.<sup>362</sup> Finally, although C-Band operators provide service in most geographic regions, several factors prevent the service from imposing significant competitive discipline on DBS. Most notably, C-Band service requires the purchase of expensive equipment and the placement of a large satellite dish that takes up a significant amount of space.<sup>363</sup> These relative competitive disadvantages of C-Band service appear to be reflected in the fact that C-Band subscribership has dropped steadily in recent years, and now stands at less than one million homes.<sup>364</sup> C-Band, therefore, is unlikely to exert significant competitive discipline on DBS pricing.

131. Because of this, we find that these alternative MVPDs are limited, either technically or in terms of geographic footprint, and accordingly conclude that these other MVPDs impose little competitive constraint on DBS operators. Given this, we believe it is reasonable, in our preliminary competitive analysis, to focus primarily on the impact of the merger on competition between cable operators and DBS providers, as have the Applicants and the merger Opponents.

132. Finally, there is no evidence in the record that suggests that there are other firms that would likely to enter the market within one year and without expenditure of significant sunk costs in response to a "small but significant and nontransitory" price increase, and that would therefore qualify as uncommitted entrants. Rather, it appears that, for new entry to occur, prospective entrants would have to

<sup>359</sup> *Id.* at 40; Application, Willig Decl. at 10-11.

<sup>360</sup> *Video Competition Repon.* 17 FCC Rcd at 1294-1297.

<sup>361</sup> *Id.* at 1277-79.

<sup>362</sup> *Id.* at 1279-81.

<sup>363</sup> See also *EchoStar v. DirecTV*, Amended Complaint ¶ 30, where EchoStar asserts that C-band technology is largely obsolete.

<sup>364</sup> *Video Competition Repon.* 17 FCC Rcd at 1277

incur significant **sunk costs** and would not be able to enter within the twelve month period indicated in the *DOJ/FTC Guidelines*.<sup>365</sup> Thus, we do not find any “uncommitted entrants” that should be counted as market participants.<sup>366</sup>

#### d. Market Shares and Concentration

133. Having adopted a provisional definition of the relevant markets and identified current market participants, we next consider whether there is a substantial likelihood that the merger will result in anticompetitive effects, such as higher prices, lower quality, or reduced incentives for innovation. Following the *DOJ/FTC Guidelines*, as well as antitrust and Commission precedent, we first examine the post-merger market concentration and the change in market concentration that is likely to result from the merger,<sup>367</sup> since concentration in the relevant markets is one indicator of the likely competitive effects of a proposed merger.

134. Under the *DOJ/FTC Guidelines*, a market with a Herfindahl Hirschman Index (“HHI”)<sup>368</sup> that exceeds 1800 is considered highly concentrated. Moreover, where the post-merger HHI exceeds 1800, and the merger produces an increase in the HHI of more than 100 points, the *Guidelines* presume that the merger is “likely to create or enhance market power or facilitate its exercise.”<sup>369</sup>

135. The Applicants claim that the post-merger HHI for MVPD industry is below 1000 and so well below the safe harbor threshold specified in the *DOJ/FTC Guidelines*.<sup>370</sup> Their analysis is fatally flawed, however. In particular, as discussed above, the Applicants define the geographic market as a national market, and in their HHI calculations they attribute a separate national market share to each cable operator. This HHI calculation is meaningless. It presumes, for example, that a Charter customer in Pasadena, California, could switch service to Cablevision in New York without moving his household.

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<sup>365</sup> *DOJ/FTC Guidelines* § 1.32.

<sup>366</sup> Cablevision is in the process of constructing a DBS satellite, “Rainbow 1 DBS,” that it intends to launch in March 2003, and plans to begin service no later than December 31, 2003. Therefore we consider Rainbow DBS in the discussion of committed or potential entrants below.

<sup>367</sup> See, e.g., *Id.* § 1.51 (“In evaluating horizontal mergers, the Agency will consider both the post-merger market concentration and the increase in concentration resulting from the merger.”); *Coasral Fuels & P.R., Inc. v. Caribbean Petroleum Corp.*, 79 F.3d 182, 196-97 (1<sup>st</sup> Cir. 1996) (“monopoly power” “may be proved circumstantially by showing that the defendant has a dominant share in a well-defined relevant market and that there are significant barriers to entry in that market.”); *Application of WorldCom, Inc. and MCI Communications Corp. for Transfer of Control of MCI Communications Corp. to WorldCom, Inc.*, 13 FCC Rcd at 18048 (“We begin our analysis of the competitive effects of the merger by assessing both the current market concentration and the likely increase in market concentration resulting from the merger...”).

<sup>368</sup> The Herfindahl-Hirschman Index is calculated as the sum of the squares of the market shares of each firm participating in a relevant market. The HHI can range from nearly zero in the case of an atomistic market to 10,000 in the case of a pure monopoly. Because the HHI is based on the squares of the market shares of the participants, it gives proportionately greater weight to carriers with larger market shares. Changes in market concentration are measured by the change in the HHI. See *DOJ/FTC Guidelines*, § 1.5.

<sup>369</sup> *Id.* at § 1.51.

<sup>370</sup> Letter from Applicants to Marlene Dortch, Secretary, FCC, Attachment (“Analysis of the EchoStar-Hughes Merger: Competitive Effects and National Pricing”), transmitted by letter from the Applicants to Marlene Dortch (June 27, 2002) at 18-19.

136. Commission staff calculated HHIs for a sample of 4,984 relevant geographic markets using data submitted by the Applicants.<sup>371</sup> We note that the Applicants' disaggregated data only includes incumbent cable providers and the two DBS providers, and does not take into account other MVPDs, such as overbuilders and C-Band providers. We do not believe that the lack of data on these other MVPDs causes a significant distortion, however, because their market shares are so small.<sup>372</sup> We also note in this regard that, although the Applicants have argued that the relevant product market includes all MVPD services, in their merger simulation analysis they examine only competition between the cable and DBS products. This appears to indicate that, when it comes to analyzing the likely competitive impacts, the Applicants acknowledge that cable systems and DBS providers are the only significant market participants.

137. The Commission staff analysis shows that the *mean* post-merger HHI for all markets to be 6043 and the *mean* increase in HHI to be 1163. The analysis also yields a *median* post-merger HHI for all markets of 5653, and a *median* increase in HHI of 861.

138. Commission staff also calculated the mean and median post merger HHIs and increase in HHIs for markets with high-capacity cable systems, with low-capacity cable systems,<sup>373</sup> and with no cable system. For markets with high-capacity cable systems, the staff analysis shows the *mean* post-merger HHI be 6704 and the mean increase to be 450, while the *median* post-merger HHI is 6693 and *median* HHI increase is 206.<sup>374</sup> For markets with low-capacity cable systems, the staff analysis shows the *mean* post-merger HHI be 5938 and the mean increase to be 1276, while the *median* post-merger HHI is 5556 and *median* HHI increase is 1003.<sup>375</sup> Finally, using a different data set, staff calculated HHIs for areas not served by cable. The analysis naturally generated a post-merger HHI of 10,000 (since the two DBS firms are the only firms in the market) and a HHI increase of **REDACTED**.

139. Thus, as this analysis indicates, the proposed transaction will increase concentration significantly in a market that is already highly concentrated. In fact, all the estimates exceed the threshold specified in the *DOJ/FTC Guidelines*, where mergers are "presumed . . . to create or enhance market power or facilitate its exercise."<sup>376</sup>

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<sup>111</sup> Letter from Applicants to Marlene Dortch, Secretary, FCC. Attachment ("3\_year\_mvpd\_data.dta"), transmitted by letter from Applicants to Marlene H. Dortch, Secretary, FCC (July 25, 2002) and Letter from Applicants to Marlene Dortch, Secretary, FCC, Attachments ("3\_year\_mvpd\_data\_prep.do" and "logit\_regressions.do"), transmitted by letter from Applicants to Marlene H. Dortch, Secretary, FCC (July 12, 2002). The Applicants' data were submitted as part of their simulation analysis, which calculated the impact of cable prices on MVPD market shares. These data specified the relative market shares for cable, over-the-air television, and each of the two DBS operators for 4,984 "local cable systems." Because we concluded that over-the-air television was not in the relevant product market, staff excluded over-the-air customers from the HHI calculation.

<sup>371</sup> According to the *Video Competition Report*, cable systems and DBS providers accounted for 96.3% of all MVPD subscribers. This indicates that other MVPDs currently do not constitute a significant Competitive force.

<sup>373</sup> The staff analysis defined a low-capacity cable system as one offering less than 53 channels of video programming and a high-capacity system as one offering at least 53 channels.

<sup>374</sup> The staff also ran the analysis using weights supplied by the Applicants. Using these weights generated a *mean* post-merger HHI of 7391 and *mean* HHI increase of 194, while the *median* post-merger HHI was 7502 and the *median* HHI increase was 101 in markets with high capacity cable systems.

<sup>375</sup> The analysis using weights supplied by the Applicants yielded a *mean* post-merger HHI of 6661 and *mean* HHI increase of 675, while the *median* post-merger HHI was 6522 and the *median* HHI increase was 280 in markets with low capacity cable systems.

<sup>376</sup> The *DOJ/FTC Guidelines* specify that mergers that produce a post-merger HHI above 1800 and an increase in the HHI of greater than 100 points will be presumed to have an anticompetitive effect. *Id.* at § 1.51.

e. **Barriers to Entry**

140. As the *Guidelines* indicate, the level of concentration and the change in the level of concentration are not the only factors that can affect the competitive significance of a merger. Thus, where market share and concentration data suggest that a particular transaction is likely to have anticompetitive effects, we then examine other structural factors that may affect the likely magnitude of any competitive effect, including in particular, entry conditions. If entry is sufficiently easy, new entrants will likely render unprofitable any attempted post-merger price increase. The *Guidelines* explain that entry is sufficiently easy to deter post-merger price increases “if entry would be timely, likely, and sufficient in magnitude, character, and scope to deter or counteract the competitive effects of concern.”<sup>377</sup> The *Guidelines* explain that entry will be considered “timely” only if it “can be achieved within *two years* from initial planning to significant market impact.”<sup>378</sup> The record in this proceeding suggests, however, that barriers to entry into the relevant market are high and that additional competitors are unlikely to be able to enter within two years in response to an attempted price increase by the merged entity.

141. Applicants contend that new entry is possible into this market. They argue that there are several orbital locations allotted by the ITU that could be used for domestic DBS service.<sup>379</sup> In addition, they claim that it is technologically feasible for entry to occur through various terrestrial platforms, including multichannel video distribution and data service (“MVDDS”).<sup>380</sup>

142. While entry may be possible, we find that there appear to be several significant barriers to timely competitive entry in the MVPD market, which makes it unlikely that any new competitor could enter and achieve a significant market presence within two years following the merger. For potential entrants that seek to provide video services via satellite, there are two major barriers to entry. First and foremost, there is a limited amount of spectrum that is both available and suitable for the provision of satellite-delivered video services.” Currently, there are only two potential entrants that possess licenses that could be used to provide competing DBS service, R/L DBS Company, LLC (“Rainbow DBS”), a wholly-owned subsidiary of Rainbow Media Holdings, Inc., which in turn is controlled by Cablevision Systems Corporation (“Cablevision”), a major cable multiple system operator (“MSO”), and SES Americom. Second, there are no additional full-CONUS slots available for the provision of high-power DBS service.

143. Pursuant to the *DOJ/FTC Guideline* test of whether entry is sufficiently easy, we consider whether “entry would be timely, likely, and sufficient in magnitude, character, and scope to deter or counteract the competitive effects of concern” and likely to occur within two years.<sup>382</sup> Of the two

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”*Id.* § 3.0.

<sup>378</sup> *Id.* § 3.2.

<sup>379</sup> Applicants Reply Comments at 49

<sup>380</sup> *Id.* at 53. In the Matter of Amendment of Parts 2 and 25 of the Commission’s Rules to Permit Operation of NGSO FSS Systems Co Frequency with GSO and Terrestrial Systems in the Ku Band Frequency Range; Amendment of the Commission’s Rules to Authorize Subsidiary Terrestrial Use of the 12.2 12.1 GHz Band by Direct Broadcast Satellite Licensees and Their Affiliates; and Applications of Broadwave USA, PDC Broadband Corporation, and Satellite Receivers, Ltd. to Provide A Fixed Service in the 12.2 12.7 GHz Band. 17 FCC Rcd 9614 (2002).

<sup>381</sup> EchoStar appeared to agree with this view when, in its antitrust complaint against DirecTV, it alleged that “[e]ntry into the high-power DBS market is fundamentally constrained by the small number of orbital slots.” *EchoStar Communications Corp. v. DirecTV Entertainment Corp.*, Amended Complaint ¶ 81.

<sup>382</sup> *DOJ/FTC Guidelines* §§ 3.0, 3.2.

potential entrants with satellite licenses, Rainbow DBS currently has licenses for 11 DBS transponders at 61.5° W.L.<sup>383</sup> Cablevision states that Rainbow DBS is in the process of constructing a DBS satellite, "Rainbow 1 DBS," and that it intends to launch Rainbow 1 DBS in March 2003 and initiate service in December, 2003.<sup>384</sup> Nonetheless, based on the record before us, we cannot include Rainbow DBS within the category of potential entrants for purposes of our competitive analysis. Even if Rainbow 1 DBS is successfully launched on schedule, it is highly unlikely that the operator could roll-out this new service and acquire a significant customer base sufficient to off-set the likely competitive harms of the proposed merger within two years. There are simply too many uncertainties associated with the launch of a new satellite, operation of associated ground facilities, acquisition of distribution agreements with local equipment retailers and installers, and deployment of a new DBS service to assume that Rainbow DBS could have a significant competitive impact within the relevant two-year timeframe. This may be particularly true under today's difficult market conditions.

144. The second potential entrant, SES Americom, filed an application on April 25, 2002, to provide service in the United States using a satellite licensed by Gibraltar at the 105.5° W.L. orbit location, which is currently pending.<sup>385</sup> SES Americom plans to offer satellite capacity on a wholesale basis for third party direct-to-home services to consumers in the United States. Specifically, SES Americom proposes to operate a DBS system at 105.5° W.L. (12.2-12.7 GHz bands 17.3-17.7 GHz feeder links), using an open platform approach (which is used by its affiliate, Astra, in Europe). SES Americom currently holds an FCC license for the 105° W.L. orbit location in both the Ku and Ka-bands. The 105.5° W.L. location is, however, only 4.5° away from each of two U.S. DBS orbital locations – 101° W.L. and 110° W.L. The Commission has never licensed DBS satellites less than 9° apart before. EchoStar and DirecTV are opposing the SES Americom proposal because of potential interference concerns. In response to a request from the Radiocommunications Agency of the United Kingdom, we accepted a proposal to permit operator to operator negotiations on these issues.<sup>386</sup> SES Americom reports that as of August 2002 neither EchoStar nor DirecTV has met with it for the required technical discussions.<sup>387</sup> Even assuming that negotiations commence in a timely manner, it appears unlikely that SES Americom,

<sup>381</sup> As a condition to the merger, Cablevision requests that EchoStar transfer 17 transponders from the 61.5° W.L. in order to provide effective competition to New EchoStar. Cablevision also requests that the Commission require EchoStar to lease capacity on its EchoStar-3 satellite to Cablevision for not less than three years. See Letter from Benjamin J. Griffin, Counsel for Cablevision and R/L DBS Co., to Marlene H. Dortch, Secretary, FCC, (July 11, 2002) (Cablevision July 11 *ex parte*).

<sup>384</sup> See Cablevision Sept. 18 *ex parte*; Application of R/L DBS Company, LLC for Modification of Direct Broadcast Satellite Authorization to Launch and Operate its DBS Satellite, Rainbow 1, at 61.5° W.L., File No. SAT-MOD-20020408-00062, DBS8701. Cablevision states that the new satellite would use 13 transponders at the 61.5° W.L., including the 11 transponders licensed to Cablevision and two "unallocated transponders. It states that it will allocate transponders to either spot beams (regional programming) or CONUS beams (national programming) and, using a 21 spot-beam configuration, could reach 143 DMAs. Cablevision asserts that this new satellite system will employ the latest and most efficient technologies, including advanced compression, set-top boxes, and allocation of frequencies for either spot-beams or CONUS beams. *Id.* at 5-7. Cablevision sets forth a table showing programming configuration options with 8PSK modulation and MPEG-2 and MPEG-4 compression. Cablevision has also requested, as a condition of our approval of the proposed transaction, that we order the divestiture of 17 DBS channels at 61.5° W.L. so that Rainbow DBS could provide an enhanced DBS product from its satellite located in this partial-CONUS slot. See Letter from Howard J. Symons, Mintz Levin on behalf of Cablevision and R/L DBS Company to Marlene H. Dortch, Secretary, FCC (Sept. 12, 2002).

<sup>385</sup> File no. SAT-PDR-20020425-00071.

<sup>386</sup> Letter from Pat Strachan, UK RA to Thomas Tycz, FCC (May 7, 2002), and letter from Kathryn O'Brien, FCC to Pat Strachan, UK RA (June 28, 2002).

<sup>387</sup> See *SES AMERICOM Inc. Petition for Declaratory Ruling SAT-PDR-20020425-00071*, August 23 2002, at ¶2.

Echostar, and DirecTV will have resolved all technical issues, and that **SES** Amcom will have received regulatory approval, launched a satellite and have had a significant market impact on the retail MVPD market within two years.

145. Compass Systems, Inc., a company 100% owned by Northpoint Technologies, Ltd., has filed an application for a construction permit for a DBS system and for authorization for a terrestrial platform in the DBS frequencies (“SouthPoint Application”).<sup>388</sup> The SouthPoint Application has four parts: (1) an application for authority to construct a DBS system; (2) a request for the Commission to exercise its discretion to grant immediately an “interim assignment” of 32 DBS channels at each of the two vacant U.S. DBS positions of 166° W.L. and 157° W.L. for the applicant’s proposed DBS satellites; (3) a request for immediate authorization of a multichannel video and broadband service through an “integrated terrestrial platform” located on the ground in the United States; and (4) a discussion of future plans for providing DBS service to the United States, Canada, and Mexico and for providing FSS to other nations.<sup>389</sup> To date, we have not yet taken action on this application. Thus, similar to the situation with respect to **SES** Americom, it is also unlikely that Compass Systems could resolve all outstanding regulatory issues, launch a DBS system, construct its proposed terrestrial platform and have a significant market impact within two years.

146. WSNET Holdings, Inc. (“WSNet”) does not currently hold an FCC license, but has filed an application for a transmit/receive earth station in Cohoes, New York, near Albany.<sup>390</sup> WSNET proposes to uplink programming from the earth station in New York to two Canadian DBS satellites located at 91° W.L. and 82° W.L. for distribution to the million customer premises receiving terminals in the U.S. Because this application has yet to be approved, the competitive entry and impact of WSNET in the MVPD market is also unlikely to occur within the relevant timeframe.

147. For the reasons stated above, we find that none of these potential entrants utilizing satellite-based technologies are likely to be able to enter the domestic retail MVPD market and achieve a significant market impact within two years.

148. A second class of potential entrants consists of cable overbuilders. Currently, overbuilders have a small market share with one million customers nationwide and a presence in franchise areas that cover only 17 million homes. A potential wireline MVPD entrant, such as a cable overbuilder, faces several major barriers to entry. First, an overbuilder would have to make a significant up-front investment in order to deploy its network, before it could begin acquiring a significant market presence. In the current financial markets, finding funding to support these sunk investments has become increasingly problematic. Indeed, existing overbuilders have been scaling back their plans to enter markets rather than accelerating them.” Second, the incremental costs of serving a new customer are

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<sup>388</sup> See Application of Compass Systems, Inc. for Authority to Construct an International Direct Broadcast Satellite System (filed March 20, 2002).

<sup>389</sup> The applicant discusses other operations but these operations are not covered by the application and are not before the Commission at this time. For instance, the applicant indicates that the spacecraft at 166° W.L. will provide service to Alaska, Hawaii, and the Continental United States (CONUS) except for the East Coast, using the 32 DBS channels at this position. The applicant also indicates that a steerable beam using FSS frequencies will be included for potential coverage of a selected area in the Eastern Pacific. The applicant indicates that the spacecraft at 157° W.L. will provide service to Canada, Mexico, and the CONUS except for the East Coast using the 32 DBS channels at this position.

<sup>390</sup> File nos. SES-LIC-20011121-02186 and SES-LIC-20020111-00075

<sup>391</sup> For example RCN, a leading cable overbuilder, reported to the SEC that “As a response to the severe slowdown in the telecommunication’s industry and economy, the limited available capital resources for our industry....we revised our growth plan accordingly during the second quarter 2002....Under the revised plan, the Company has

(continued...)

likely to be higher for an overbuilder than they would be for a satellite provider.<sup>392</sup> Third, it generally takes a significant amount of time to enter a local market through construction of a new wireline MVPD system over public rights-of-way due to the need to satisfy local permitting, franchising and other requirements.

149. Finally, with respect to terrestrial MVDDS providers, we note that petitions for reconsideration of our spectrum allocation and service rules are pending. In addition, the Commission plans to assign licenses by auction, and the licensees will have flexibility as to the specific services they may offer. Consequently, it appears unlikely that any MVDDS licensee will be able to enter the MVPD market and achieve a significant market impact within two years.

150. It therefore, appears that the proposed merger will not only significantly increase concentration in a market that is already highly concentrated, but that potential entry that could defeat any attempt by the merged entity to raise prices is unlikely. Thus, under traditional structural antitrust analysis, there appears to be a substantial likelihood that the proposed merger will significantly increase concentration in an already concentrated MVPD market, that barriers to entry into this market are high, and that proposed merger will therefore have a significant adverse effect on competition.

## 2. Analysis of Potential Adverse Effects on Competitive Behavior.

151. Because the foregoing structural analysis suggests that the merger is likely to have an adverse effect on competition, it is necessary to examine in more detail whether, and how, the merger may affect competitive behavior. As the *DOJ/FTC Guidelines* make clear, competition may be harmed either through unilateral actions by the merged entity or through coordinated interaction among firms competing in the relevant market.”

152. Unilateral effects arise when the merging firm finds it profitable to alter its behavior following the merger. Examples of unilateral effects include a merging firm’s raising its price or reducing the quantity it supplies.<sup>394</sup> Coordinated effects, in contrast, arise when competing firms, recognizing their interdependence, take actions “that are profitable for each of them only as a result of the accommodating reactions of others.”<sup>395</sup> Because coordinated effects generally are more likely the smaller the number of firms in a market, mergers may significantly increase the likelihood of coordinated effects by reducing the number of firms. Examples include explicit collusion, tacit collusion, and price leadership. We will discuss each of these in turn.

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(...continued from previous page)

substantially curtailed future capital spending and network geographic expansion in all existing markets. focuses on continuation of customer acquisition growth and has reduced operating expenses.” *RCN Corp “Quarterly Report (SECform 10-Q)”* August 14, 2002 at 24.

<sup>392</sup> For a satellite provider, the incremental cost of an additional customer is the cost of the dish and set-top box. In contrast, the incremental cost of an additional customer for an overbuilder, entering a new area would involve deploying MVPD facilities to residential areas, which could be significant.

<sup>393</sup> *DOJ/FTC Guidelines* § 2.

<sup>394</sup> *Id.* at § 2.2.

<sup>395</sup> *Id.* at § 2.1.

**a. Unilateral Effects**

153. It is generally recognized that, as a result of a merger, the merging firms “may find it profitable to alter their behavior unilaterally . . . by elevating price and suppressing output.”” A merger may lead to particularly strong increases in the merged firm’s ability to affect market performance unilaterally when the merging firms compete in a differentiated products market, and the firms’ products are close substitutes for each other. “A merger between firms in a market for differentiated products may diminish competition by enabling the merged firm to profit by unilaterally raising the price of one or both products above the pre-merger level. . . . The price rise will be greater the more the buyers of one product consider the other product to be their next choice.”” Therefore, if the services offered by EchoStar and DirecTV are viewed as close substitutes by significant numbers of customers, the merger of the two firms can remove the strongest constraint on the acquiring firm’s ability to raise prices. Similarly, if high-capacity cable systems are viewed as a closer substitute for DBS than low-capacity cable systems, then the merged entity will have an incentive to raise price more in areas that are served by low-capacity systems.

154. The Applicants and Opponents disagree concerning the relative substitutability between EchoStar service and DirecTV service on the one hand, and between DBS service and cable service on the other. There is also conflicting evidence as to the relative substitutability of low-capacity cable systems and DBS compared with high-capacity cable systems and DBS. Although the Applicants concede that the two DBS companies compete to some extent, they contend that “this competition is dwarfed in comparison to DBS competition with cable.”<sup>398</sup> The Applicants’ expert, Dr. Willig, argues, for example, that EchoStar and DirecTV do not compete intensely against each other, and so their merger is unlikely to produce any substantial increase in DBS prices.<sup>399</sup> Dr. Willig further claims that the primary objective of EchoStar and DirecTV is to gain market share by luring consumers away from the leading cable providers and not from each other. Thus, according to Dr. Willig, both firms price their DBS programming services at levels based primarily on the prices charged by cable providers.<sup>400</sup> Dr. Willig also contends that, while EchoStar and DirecTV each monitor the pricing of the other firm, DBS pricing plays little (if any) role in their own pricing decisions.” Dr. Willig also suggests that a unilateral price increase by New EchoStar is unlikely because the merger would reduce New EchoStar’s marginal cost, in part by reducing its per-subscriber programming costs.<sup>402</sup>

155. Opponents challenge the Applicants’ claim that EchoStar and DirecTV do not compete vigorously with each other. NRTC, Pegasus and NAB submit evidence that EchoStar and DirecTV are currently each other’s closest competitors and that loss of intra-DBS competition would have substantial detrimental effects on consumers.” NAB and Pegasus argue that the companies compete fiercely on

<sup>396</sup> *Id.* § 2.2

<sup>397</sup> *Id.* 52.2 I.

<sup>398</sup> Applicants’ Reply Comments at 38.

<sup>399</sup> *Id.*, Willig Decl. at 43-44

<sup>400</sup> *Id.* at 38, Willig Decl. at 6.

<sup>401</sup> *Id.*, Willig Decl. at n. 5. [In support of their argument, the Applicants note DirecTV’s lack of response to EchoStar’s “I like 9 pricing campaign. In August 2001, new EchoStar customers who purchased a system for \$199 or more, received EchoStar’s “America’s Top 100” programming package for \$9.00 per month for one year. EchoStar usually charges \$30.99 per month. Willig Declaration at n. 6.

<sup>402</sup> *Id.* at 22.

<sup>403</sup> *See, e.g.* Pegasus Petition at 14, NRTC Petition at 31-35; NAB Petition at 15-31.

price and track each other's program offerings.<sup>404</sup> Dr. MacAvoy and Mr. Sidak, on behalf of NRTC and NAB respectively, submit evidence that the two DBS companies price competitively with each other, and thus, they claim that elimination of the competition will produce price increases.<sup>405</sup> NAB also contends that EchoStar and DirecTV compete intensely for the retail distribution of their products.<sup>406</sup> NRTC and NAB suggest that the nearly simultaneous launch of local-into-local television broadcast service in major markets by EchoStar and DirecTV reflects the intense, direct competition between the two DBS operators.<sup>407</sup>

156. Opponents also contend that EchoStar's and DirecTV's services are closer, in terms of product characteristics, than are DBS and cable services. NAB, for example, asserts that EchoStar and DirecTV are the closest substitutes for one another "as the only significant satellite providers" of MVPD programming. It further argues that DBS is significantly differentiated from cable in terms of price, number of channels of programming, quality, and additional technical features such as pay-per-view options.<sup>408</sup>

157. Finally, Pegasus claims that certain low capacity cable systems are not effective competitors to DBS.<sup>409</sup> It claims that older, low-capacity cable systems fail to offer the services, channel capacity, and technological advances to compete with DBS. Similarly, NAB claims that New EchoStar will have the incentive and power to raise prices and reduce service quality in areas served by low capacity cable systems.<sup>410</sup>

158. *Merger Simulations Estimating Unilateral Effects.* In this proceeding, both parties opposing the merger and the Applicants submitted merger simulations that estimated the likely economic loss or gain to consumers from the merger. Dr. MacAvoy, on behalf of NRTC, estimates an annual consumer welfare loss of between \$120 million and \$700 million in areas not served by cable, while Mr. Sidak, on behalf of NAB, projects an annual consumer welfare loss of approximately \$700 million for the entire United States.<sup>411</sup> To rebut these studies, the Applicants submitted their own merger simulation which projected annual consumer benefits of **REDACTED**. In addition, Commission staff performed a sensitivity analysis to determine how sensitive the merger simulation estimates are to variations in demand and cost parameters.

159. As discussed below, and in greater detail in Appendix E, we find fundamental flaws in, and have numerous unanswered questions concerning, the Applicants' merger simulation. More specifically, we find that the Applicants' claim that the merger will result in lower MVPD prices (despite the significant increase in market concentration) depends largely on the validity of their assumptions (or estimates) concerning: (I) the low cross-price elasticity of demand for EchoStar's and DirecTV's

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<sup>404</sup> NAB Petition at 16-19; Pegasus Petition, Rubinfeld Aff. at 9. NAB claims that direct head-to-head competition is evident in sports programming, movies, and international programming decisions, because when one company offers a new type of programming, the other follows suit. NAB Petition at 24-28.

<sup>405</sup> NAB Petition, Sidak Decl. at 68-70, NRTC Petition, MacAvoy Decl. at 31-33.

<sup>406</sup> NAB Petition at 31

""NRTC Petition at 34; NAB Petition at 19-24.

<sup>408</sup> NAB Petition at 53.

<sup>409</sup> Pegasus Petition at 18.

<sup>410</sup> NAB Petition at 58.

<sup>411</sup> NAB Petition, Sidak Decl. at 29, NRTC Petition, MacAvoy Decl. at 51. For more detail on the merger simulation technique see Appendix E.

services:" (2) the high own-price elasticities of demand for EchoStar and DirecTV;<sup>413</sup> (3) current marginal costs; and (4) projected marginal cost savings. We find these assumptions and estimates to be flawed or unsupported or both. We discuss each of these issues in turn.

160. First, as discussed in Appendix E, the methodology the Applicants use to compute the cross-price elasticities of demand is fatally flawed, and their estimate of a low degree of substitutability between EchoStar and DirecTV service is simply not credible. In addition, the conclusion that EchoStar and DirecTV do not really compete against each other is inconsistent with the characteristics of the DBS services offered by the Applicants, contradicted by documents submitted by the Applicants, and undercut by the allegations contained in the antitrust suit EchoStar filed against DirecTV.<sup>414</sup>

161. As Dr. Sidak explains in his testimony, the Applicants are "... asking the Commission to believe that (1) EchoStar is a substitute for cable television service, and (2) cable television is a substitute for DirecTV, but (3) EchoStar is not a substitute for DirecTV and DirecTV is not a substitute for EchoStar."<sup>415</sup> We agree with NAB on this point and find that these premises make little sense given the close similarities between the service packages offered by EchoStar and DirecTV, and the much greater differences between those service packages and services offered by cable companies.

162. Indeed, the similarity of their product offerings is at the very heart of the Applicants rationale for merging. The Applicants claim that of the 286 national channels carried by EchoStar, 240, or 84% are duplicated by DirecTV, and of the total 709 channels carried by EchoStar, 588 or 83% are also carried by DirecTV.<sup>416</sup> Moreover, the degree of overlap is even more pronounced in their most popular packages. EchoStar's "America's Top 100" and DirecTV's "Total Choice" packages both offer over 80 channels of video and over 30 channels of audio. Furthermore, none of the non-shared channels accounted for more than 0.08 all-day Nielsen share.<sup>417</sup> The prices that EchoStar and DirecTV charge are also remarkably similar. Currently, the Applicants each offer promotions in which the total price of a one year contract, including installation, activation fee and a year's programming is \$456.88 for EchoStar and \$446.83 for DirecTV.<sup>418</sup> Thus, the Applicants are selling virtually identical products at almost the same price. If, as the record suggests, EchoStar and DirecTV services are close substitutes in the eyes of MVPD consumers, then the post-merger prices of EchoStar and DirecTV as well as cable subscription prices will be significantly higher than those predicted by the Applicant's model.<sup>419</sup>

<sup>412</sup> The *cross price elasticity of goods A and B* is the percentage change in demand for good A that results from a percentage change in the price of B.

"The *own price elasticity of good A* is the percentage change in demand for good A that results from a percentage change in the price of A.

<sup>414</sup> See n.337, *supra*; See also *EchoStar Communications Corp. v. DirecTV Entertainment Corp.*, Complaint ¶¶ 5-6, 26-85.

<sup>415</sup> NAB Petition, Sidak Decl at 44

<sup>416</sup> EchoStar May 16 *ex parte* at 17.

<sup>417</sup> Of the non overlapping channels, only Travel Channel earned a rating, see Kagan World Media. "Cable Program Investor." (July 29, 2002) at 11

<sup>418</sup> EchoStar offer through Sears, offer code: IVCDHP, August 2002. DirecTV offer through American Express. offer code: AMEX, June 2002.

<sup>419</sup> For example, Dr Sidak, for NAB, performs a similar merger simulation to the Applicants assuming a higher elasticity of substitution and finds that prices would rise 7.3% for EchoStar and 3.5% for DirecTV. NAB Petition. Sidak Decl. at 28.

163. In addition, the record is replete with evidence that EchoStar and DirecTV do indeed compete vigorously with each other and that this competition effectively constrains prices. For example in their lawsuit challenging the validity of the SHVIA must carry rules, the Applicants stated that “Satellite carriers are in competition both among themselves and with local and regional cable systems across the United States for subscribers.”<sup>420</sup>

164. Most tellingly, the allegations made by EchoStar in the context of the antitrust suit it filed against DirecTV undercut the Applicants’ arguments here that their main competitor is cable and not the other DBS provider.” For example, in its Amended Complaint, EchoStar alleged that “[n]o other product duplicates or fully substitutes for . . . the high-power DBS subscription TV programming service.”<sup>422</sup> EchoStar further alleged:

Without high-power DBS customers cannot receive the same approximate number, type, and variety of television channels or quality. Thus, customers do not consider either over-the-air broadcast or cable TV service to be effective substitutes for high-power DBS equipment and service.”<sup>423</sup>

Thus, EchoStar itself, in sworn legal pleadings filed in its antitrust suit against its now merger partner, DirecTV, contended that the services offered by itself and DirecTV were closer substitutes than were services offered by cable companies or over-the-air broadcasters.

165. Second, we find the estimated current marginal costs generated by the Applicants’ merger Simulation model to be inconsistent with other data submitted by the Applicants in the record. As discussed in Appendix E, the Applicants’ merger simulation implies a marginal cost per customer that is inconsistent with the cost data on the record. Data submitted by the parties in response to our data request suggests, however, that the actual marginal cost per customer is approximately REDACTED less.<sup>424</sup>

166. Third, based on the above observation, we are highly skeptical of the Applicants’ estimated own-price elasticity of demand of REDACTED?” First, the Applicants did not obtain these estimates directly from DBS demand data. In addition, the estimates differ significantly from past estimates of MVPD elasticities. If these estimates are more negative than the true values, then the Applicants analysis will underestimate the extent to which post-merger prices will rise.

167. Finally, as discussed below in our analysis of the claimed merger benefits, we have serious questions and doubts concerning the Applicant’s projected cost reductions, which they claim will result from the merger.

168. Given the apparent flaws in the Applicants’ analysis, Commission staff undertook a sensitivity analysis of the merger simulations in order to determine how sensitive changes in consumer welfare were to variations in demand elasticities and marginal cost estimates. The staff analysis, which is discussed in greater detail in Appendix E, found that estimated welfare gains or losses from the merger

<sup>420</sup> See Nov 6 2000 Memorandum in Support of Plaintiffs Motion for Summary Judgment as to First Amendment Issues in Satellite Broadcasting Communications Association of America et al v. F.C.C. et al.

<sup>421</sup> *EchoStar Communications Corp. v. DirecTV Enterprises, Inc.*, Civ. Action No. 00-K-212 (DColo. 2000).

<sup>422</sup> *EchoStar Communications Corp. v. DirecTV Entertainment Corp.*, Amended Complaint at ¶78.

<sup>423</sup> *Id.* at ¶ 79.

<sup>424</sup> See Appendix E.

<sup>425</sup> Presentation by A. Joskow and R. Willig at 49 (July 2, 2002).

will vary significantly depending on the assumed demand elasticities and marginal cost savings. Estimates of the consumer welfare losses can range as high as REDACTED per year. This sensitivity analysis indicates that the issue of whether the merger will generate a net benefit or harm to consumers and the magnitude of that benefit or harm will depend critically on the values of the model parameters. In particular, the results will vary with the estimates of the own-price and cross-price elasticities of demand and the estimated efficiencies resulting from the merger.

169. With respect to these key parameters, we find the Applicants' model to be severely flawed and the model's results of net consumer benefits to be highly suspect. These findings are discussed more fully in Appendix E. We can give little credence to the Applicants' model parameters, particularly estimates of the demand elasticities for DBS and the pre-merger marginal costs of the Applicants. Moreover, because the data in the record are insufficient to determine with precision estimated own-price and cross-price elasticities of demand or projected savings in marginal costs, we can not determine independently and conclusively, the precise level of likely consumer harm that the proposed merger will cause. Nevertheless, the record suggests that the services provided by DirecTV and EchoStar are significantly closer substitutes than those offered by cable systems. This strongly suggests that, in the absence of any significant savings in marginal cost, the merger will result in a large increase in post-merger equilibrium prices. Given this likelihood, we cannot find that the Applicants have met their burden of demonstrating that the proposed merger will produce merger-specific public interest benefits of the magnitude the Applicants allege.

#### b. Coordinated Behavior

170. Both economic theory and empirical economic research have shown that firms in concentrated, oligopoly markets<sup>426</sup> take their rivals' actions into account in deciding the actions they will take.<sup>427</sup> When market participants' actions are interdependent, noncompetitive collusive behavior that closely resembles cartel behavior may result – that is, high and stable prices.<sup>428</sup> Such collusion or “conscious parallelism” may arise not because of any explicit agreement between the sellers “. . . but solely through a rational calculation by each seller of what the consequences of his price decision would be, taking into account the probable or virtually certain reactions of his competitors.”<sup>429</sup> Economists have further recognized that mergers that cause significant increases in concentration may increase the likelihood of coordinated effects.<sup>430</sup>

171. The view that increased market concentration may increase the likelihood of anticompetitive, coordinated conduct has also been recognized by the Courts. For example, in the *Heinz* case discussed above, the court observed that “[m]erger law rests upon the theory that, where rivals are few, firms will be able to coordinate their behavior, either by overt collusion or implicit understanding, in order to restrict output and achieve profits above competitive levels.”<sup>431</sup> The court went on to state that

<sup>426</sup> An oligopoly market is a market in which only a small number of firms compete. See, e.g., DENNIS W. CARLTON & JEFFREY M. PERLOFF, *MODERN INDUSTRIAL ORGANIZATION* 7-8 (2d ed. 1994)

<sup>427</sup> Viscusi, Vernon and Harrington, *Economics of Regulation and Antitrust* MIT Press 2000, at 107.

<sup>428</sup> Douglas F. Greer, *Industrial Organization and Public Policy*, MacMillan 1992, at 269.

<sup>429</sup> D.F. Turner, *The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusals to Deal*, *Harvard Law Review* (February 1962) at 661.

<sup>430</sup> See John Kwoka, Jr., “The Effect of Market Share Distribution on Industry Performance,” *The Review of Economics and Statistics*, at 101-9, Feb. 1979.

<sup>431</sup> *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 715 (D.C. Cir. 2001) (quoting *FTC v. PPG Indus.*, 798 F.2d 1500, 1503 (D.C. Cir. 1986)).

“[i]ncreases in concentration above certain levels are thought to ‘raise[] the likelihood of interdependent anticompetitive conduct.’”<sup>432</sup>

172. A number of merger Opponents contend that, because of the nature and characteristics of the DBS industry, coordinated anticompetitive effects are likely to result from the merger.” NAB, for example, suggests that no market is more conducive to coordinated interaction than duopoly, and that coordinated effects will be exacerbated in the MVPD market for two reasons: **(1)** there will be no full-CONUS slots from which another DBS competitor could compete against the merged entity, thereby creating a substantial barrier to entry into the MVPD market; and **(2)** a firm that might currently be viewed as a relatively small “maverick firm” in a market with only three major participants will no longer serve that role post merger.<sup>434</sup> Mr. Sidak. NAB’s economic expen. further suggests that the uniform national pricing policy could facilitate collusion between New EchoStar and cable operators because the uniform pricing policy would penalize, and thus limit, selective price reductions below an agreed-upon level by New EchoStar.<sup>435</sup>

173. Economists have identified several factors, which tend to increase the possibility of collusion. Collusion appears more likely, other things being equal, when: (1) there are few firms in the market; (2) there are high barriers to entry; (3) products are relatively homogeneous; (4) contracts are for relatively short periods, and the prices and terms are observable by other sellers; and (5) market conditions are relatively stable.<sup>436</sup> These factors suggest that the Applicants’ proposed merger will increase the likelihood of coordinated anticompetitive behavior. First, even where consumers have access to cable, the merger would reduce the number of major MVPD operator5 to two – New EchoStar and cable – in most franchise areas. Second, as previously discussed, the market exhibits high barriers to entry. Third, cable and DBS operators would be able to observe each other’s marketing and pricing behavior, and so would be able to monitor whether implicit parallel prices were being maintained.<sup>437</sup> Fourth, MVPD operators generally do not enter into lone-term contracts with their subscribers. Consequently, if one operator were to deviate from an implicit pricing agreement, the other operator would be able to respond quickly in an effort to win back the customers, thereby rendering unprofitable any deviation from the established parallel prices. The merger would exacerbate some of these condirions by reducing the number of firms in the market, increasing market concentration.

<sup>432</sup> *Id.* at 175-16 (quoting *U.S. v. General Dynamics*, 415 U.S. 486, 497 (1974)).

<sup>433</sup> Pegasus Petition at 21, 30-31.

<sup>434</sup> NAB Petition at 54-55. NAB cites the DOJ Merger Guidelines which discuss maverick firms in relationship to coordinated behavior: “In some circumstances, coordinated interaction can be effectively prevented or limited by maverick firms – firms that have a greater economic incentive to deviate from the terms of coordination than do most of their rivals (e.g., firms that are unusually disruptive and competitive influences in the market.) *Merger Guidelines* § 2.12.

<sup>435</sup> NAB Petition, Sidak Decl. at 34-35. Salop has shown that an identical posted price is similar to “most-favored-nation” clause in a sales contract that provides the buyer with protection against any price discrimination i.e., when seller offers discounted price to another buyer. Using standard oligopoly models, Salop shows that most-favored-nation causes rival firms to act co-operatively. See, Steven Salop, “Practices That (Credibly) Facilitate Oligopoly Coordination.” in Joseph E. Stiglitz and G. Frank. Mathewson, eds., *New Developments in Analysis of Market Structure*. MIT Press, 265-290.

<sup>436</sup> See, e.g., Alexis Jacquemin & Margaret Slade, *Cartels, Collusion, and Horizontal Merger*, in 1 HANDBOOK OF INDUSTRIAL ORGANIZATION 415 (1989); F.M. Scherer “*Industrial Market Structure and Economic Performance*.” Houghton Mifflin, 1980 at 199-200. See also T.F. and Peter C. Reiss, “Entry and Competition in Concentrated Markets.” *Journal of Political Economy*, (1991) at 977-1009. JEAN TIROLE, THE THEORY OF INDUSTRIAL ORGANIZATION 245- 253 (1988) (discussing factors facilitating coordinated effects).

<sup>437</sup> As discussed in section V.B.4. *infra*, this factor may be exacerbated by the proposed national pricing plan.

174. In sum, basic economic principles and the characteristics of the market suggest that the proposed merger may increase the likelihood of collusion among MVPD providers. This would result in harms accruing to the vast majority of MVPD service consumers in the nation. Consequently, the consumer harms resulting from unilateral effects discussed above, which were estimated assuming the remaining MVPD operators did not collude, may understate the harms that would actually result from the merger.

### 3. Reduction in the Magnitude of Future Innovation and in the Quality of Service

175. The MVPD market since the introduction of DBS competition is replete with examples of how competition has spurred innovation. Certain merger Opponents contend that the merger would reduce future innovation in DBS or result in a degradation in the quality of service. NAB, for example, claims that competition between EchoStar and DirecTV has spurred tremendous technological innovation, as evidenced by the introduction of dual-feed dishes, interactive multimedia programming, Personal Video Recorders ("PVRs") built into set-top boxes, and spot beam satellites.<sup>438</sup> NRTC argues that innovation in set-top box is best driven by competition, and that a monopolist would retard product innovation in set-top boxes.<sup>439</sup> NAB also claims that competition between DirecTV and EchoStar "has resulted in significant consumer benefits, including: aggressive marketing and pricing; diverse programming packages; expanded local-to-local service; and innovative advanced technologies[.]" which will be jeopardized as a result of the merger.<sup>440</sup> AAI argues that EchoStar and DirecTV are strong, direct competitors, and that continued DBS competition will help to ensure ongoing competitive discipline of DBS and cable operators.<sup>441</sup> The Applicants respond that the proposed merger will enable the merged entity to be more innovative and to better compete with cable.<sup>442</sup>

176. The evidence in the record suggests that the merger would likely reduce innovation and service quality. In recent years, the Applicants have improved their services, increased the variety of programming and non-programming options that they offer, and enhanced the technical capabilities of their equipment. At least some of these changes appear to have been motivated by the competitive pressure that each operator exerts on the other. The evidence further suggests that the two operators compete directly with each other for new customers and that the benefits of this competition would be lost if the merger were consummated. Thus, although the Applicants claim that they do not compete with each other, the record and our analysis appear strongly to contradict this assertion.

177. The lessened competitive pressure from the combination of the two DBS firms might well reduce New EchoStar's incentive to improve services and quality. This would be particularly true in areas where subscribers are unserved or underserved by cable operators. We therefore find that this is a potential harm from the proposed merger.

### 4. National Pricing

178. The harms that consumers are likely to suffer from the higher prices likely to result from the post-merger market structure depend, at least in part, upon New EchoStar's ability to set different

<sup>438</sup> NAB Petition at 28-20.

<sup>439</sup> NRTC Petition at 66.

<sup>440</sup> NAB Petition at 15.

<sup>441</sup> AAI Comments at 2-3.

<sup>442</sup> Applicants' Reply Comments at 20-30.

prices in different geographic regions. Responding to concerns that New EchoStar would be able to raise price and exploit its dominant position in geographic regions not served by cable systems, the Applicants early on proposed their own remedy. Noting that they currently set monthly recurring prices on a nationwide basis, the Applicants committed New EchoStar to "pricing its DBS services on a uniform, nationwide basis."<sup>443</sup> The Applicants state that they will begin implementing this uniform nationwide pricing plan immediately upon regulatory approval of the merger, and that it will become "fully operational as soon as 24 months thereafter."<sup>444</sup> Dr. Willig, the Applicants' economic expert, claims that, as a result of this commitment, "prices for rural customers will be driven by competition in urban areas."<sup>445</sup> Dr. Willig further argues that the nationwide "monthly service prices" are unlikely to rise as a result of the merger, because these prices are "generally driven by prices set by the major cable MSOs throughout the country, which often face competition from overbuilders and other MVPD providers."<sup>446</sup> As discussed below, the Applicants' commitment does not appear to preclude the possibility that customers in areas without access to cable will not be subject to price or quality discrimination or to a post-merger price increase. In fact, the Applicants admit that the uniform price guarantee would only apply to monthly programming fees, but not to the price of equipment or installation, and they appear to want to retain the ability to charge different programming prices in order to meet competition. Moreover, such a commitment, if implemented, may dampen competition between New EchoStar and cable operators.

**179.** Opponents criticize the uniform pricing proposal on a number of grounds. First, they argue that it is likely to be ineffective, since, even if New EchoStar set uniform monthly fees for programming services, it could discriminate against customers lacking access to cable through other means, including: (1) charging different prices for equipment and/or installation; (2) offering fewer free months of programming to such customers than it offers to customers with cable alternatives; (3) varying the number of channels available in various programming packages; and/or varying the number of local channels; and (4) providing different levels of customer service.<sup>447</sup> Quoting statements by EchoStar's Chairman and CEO, Mr. Ergen, Opponents further suggest that New EchoStar will insist on retaining the ability to respond with targeted promotions to promotions offered by local cable companies.<sup>448</sup> Second, Opponents argue that, even if it were possible to enforce a uniform national price, that single price would exceed the pre-merger prices for both customers that have access to cable and those that do not.<sup>449</sup> Finally, NAB contends that a uniform price policy would reduce the incentive of New EchoStar to cut prices in order to better compete with a particular cable system, since it would then have to cut prices nationwide.<sup>450</sup>

**180.** In response to the criticism that, despite the commitment to charge uniform monthly rates, New EchoStar could still discriminate against customers in areas without cable, the Applicants first

<sup>443</sup> Application at 42. See also Applicants' Reply Comment at ii ("Consumers across the country will pay the same price for this DBS service, *i.e.*, one nation, one rate card, regardless of a subscriber's location."). The Applicants further note that "[n]ational pricing is the most practicable and efficient method of DBS pricing." Application at 34.

<sup>444</sup> Applicants' Reply Comment at 2.

<sup>445</sup> Application, Willig Decl. at 25.

<sup>446</sup> *Id.*

<sup>447</sup> See, *e.g.*, NRTC Petition, MacAvoy Decl. at 53; NAB Petition, Sidak Decl. at 31 & 36; Pegasus Petition, Rubinfeld Aff. at 13.

<sup>448</sup> NRTC Petition, MacAvoy Decl. at 53.

<sup>449</sup> NAB Petition, Sidak Decl. at 31-34; NRTC Petition, MacAvoy Decl. at 52

<sup>450</sup> NAB Petition, Sidak Decl. at 34-35.

note that the national pricing commitment is consistent with the Applicants' past pricing practices. They further argue that, because of the difficulty in identifying customers that lack access to cable, it would be impractical to discriminate against such customers." With respect to the criticism that the post-merger national price would exceed the pre-merger prices, the Applicants respond that DBS pricing decisions are driven by competition with cable companies, since the majority of New EchoStar's customers have access to cable, and New EchoStar would have to attract cable subscribers in order to expand its subscriber base. Accordingly, the Applicants claim that New EchoStar is unlikely to have the incentive or ability to raise its national price because it would **not** want to lose customers to cable.<sup>452</sup>

**181.** Based on the evidence in the record, we cannot find that the national pricing plan proposed by the Applicants is likely to be an adequate or effective remedy for the competitive harms that are likely to **flow** from the proposed merger. The plan does not preclude price or quality discrimination, particularly against customers that have no access to cable systems. The Applicants' claim that such discrimination is "implausible" is contradicted by the record. For example, as recently as July 1, 2002, it was reported that DirecTV was using targeted promotions to win customers in the Los Angeles area residing within the franchise area of one particular cable operator.<sup>453</sup> In addition in filings submitted in the record and in public comments by Mr. Ergen, Chairman and CEO of EchoStar, the Applicants leave open the possibility that New EchoStar will offer "local promotions for installation and equipment" in response to promotions by competing cable companies." Moreover, the Applicants admit that the uniform pricing commitment only applies to recurring monthly programming service fees, but not to the price of equipment or installation. To the extent that New EchoStar is able to discriminate in the price charged for equipment and installation, it could effectively charge different customers different amounts for the same DBS service.<sup>455</sup> Contrary to the Applicants' contention, it does not appear that difficulties in distinguishing between customers that have access to cable from those that do not would prevent such discrimination. Rather, the record indicates that the Applicants have each implemented promotions that target customers in particular cable service areas in the past and there is no reason to believe that they could not do so again in the future.<sup>456</sup> Moreover, as explained below, it is far from apparent that the national pricing plan will prevent substantial increases in post-merger prices.

**182.** In addition, it appears that the Applicants could discriminate in terms of service quality. For example, even if New EchoStar were to offer local-to-local television broadcast programming in all **210** DMAs and charge a uniform price for that option, the fact that the number of channels varies from

<sup>451</sup> Applicants' Reply Comments at 68-70.

<sup>452</sup> *Id.*, Willig Decl. at 25-26. **32**

<sup>453</sup> Letter from Stephen E. Coran, Manatt, Phelps & Phillips, LLP, Counsel to NRTC, to Marlene H. Dortch, Secretary, FCC (Sep. 4, 2002) ("NRTC Sep. 4 *ex parte*") at Exhibit A: *See also* Applicants' Oct 8 *ex parte*, Attachment 2, 5.

<sup>454</sup> *See, e.g.*, Applicants' Reply Comment at 69 ("The ability to offer local promotions for installation and equipment will not undermine the effectiveness of national pricing as a constraint."); *See also Ergen Makes His Case*, SATELLITE BUSINESS NEWS, December 21, 2001, at p.1 (Mr. Ergen quoted as stating that "I guess if you're saying if the cable company came in and offered a rebate in one city, would you respond to that? I think you could make allowances for that."); In this regard, we note that Professor Willig only claims that "*monthly* service prices" are unlikely to rise as a result of the merger. Application, Willig Decl. at 25.

<sup>455</sup> For example, when DBS was first offered, providers charged a minimum of \$699 for equipment and \$150 for installation. Assuming that these charges are amortized over a one-year period and the discount rate is 7%, a difference of \$100 in up-front, non-recurring costs translates into a difference of \$8.65 in amortized monthly costs. *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 9 FCC Record 7002 (1994) at paragraph 65.

<sup>456</sup> REDACTED.

DMA to DMA means that the per-channel cost of local-to-local programming could vary. Since rural DMAs tend to have fewer local channels, this means that rural customers will effectively pay a higher price for local programming. In addition, the Applicants may be able to implement quality discrimination in other ways. For example, they could design programming packages, such as regional sports programming, to appeal more to customers in urban areas than in rural areas. Similarly, they might charge more for and/or take longer to complete necessary equipment repairs in rural regions.

183. Finally, we note that, while it is rational for the Applicants to want to retain the ability to respond to competition in particular local markets, this very incentive suggests that the Commission would need to monitor and enforce any uniform national pricing commitment. It would be costly and difficult for the Commission to perform such monitoring and enforcement, and it is unclear how effective its enforcement efforts would, or could, be.

184. Moreover, even if the Applicants committed to implement uniform national pricing on every element of their service, for the Commission to effectively enforce this commitment it would have to engage in intensive regulatory oversight, extending to tens of thousands of equipment retailers. The resources used in this oversight are a social cost that should be taken into consideration. Simply stated, replacing head-to-head competition with regulatory oversight not only would impose significant regulatory costs, but would also conflict with the goal of allowing competition to replace regulation, that both Congress and this Commission have long sought to achieve.

185. Furthermore, even if one assumed that regulatory monitoring could absolutely insure uniform national pricing, the merger nevertheless might well produce higher prices than prevailed before the merger. As the Applicants' expert, Dr. Willig, points out, the profit-maximizing uniform price-cost margin is inversely related to the weighted average own-price elasticity of demand, where the weights are the share of DBS customers in each market.<sup>457</sup> If the merger causes New EchoStar's own-elasticity of demand to decline in all relevant markets and New EchoStar's marginal cost does not decline sufficiently, then the profit maximizing uniform price-cost margin will rise, and thereby result in higher prices for all DBS customers.<sup>458</sup>

186. Finally, it is not clear whether a uniform national pricing policy would tend to facilitate or discourage collusive pricing, which could raise prices even higher. On the one hand, a national pricing policy facilitates information exchange among competitors, which generally promotes coordinated pricing behavior. In addition, the uniform national pricing policy may make the Applicants less likely to cheat on collusive agreements and undercut particular cable companies, because they would have to make the price cut nationwide. Thus, in some respects, the national pricing plan may make such agreements more likely. On the other hand, a national pricing policy might increase the incentive of cable companies to reduce prices, because they would know that it would be more expensive for New EchoStar to respond to, or attempt to punish, any such price reduction. Which of these tendencies is likely to dominate will be influenced by the exact nature and terms of the uniform pricing policy, which are unclear. Even if we knew the exact terms, however, it is not clear whether the uniform pricing policy would increase or decrease the likelihood of collusive pricing. In either case, however, the uniform pricing policy would not remedy any unilateral price increase that the New EchoStar would have the incentive to implement as a result of the merger.

<sup>457</sup> Applicants' Reply Comments, Willig Decl. at 27

<sup>458</sup> It is technically possible that, despite an increase in the profit-maximizing price-cost margin, DBS prices could fall if the merger resulted in a sufficiently large decline in New EchoStar's marginal cost of providing DBS service. As discussed below, however, the Applicants have not presented sufficient specific and verifiable evidence to demonstrate that the merger will result in a sufficiently large reduction in marginal cost to effectuate such a decline in consumer price.

187. For all of these reasons, we conclude that the Applicants' proposed uniform national pricing policy is unlikely to remedy the anticompetitive effects that are likely to result from the merger in both rural and urban markets, and could, in fact, exacerbate the harms.

### C. Potential Public Interest Benefits – MVPD Market

188. We next consider evidence of efficiencies and other public interest benefits that Applicants claim will result from the proposed merger. Under Commission precedent, the burden of persuasion is on the parties proposing the transfer of a license or authorization to show that the potential public interest benefits of the transfer outweigh the potential public interest harms.<sup>459</sup> "Efficiencies generated through a merger can mitigate competitive harms if such efficiencies enhance the merged firm's ability and incentive to compete and therefore result in lower prices, improved quality, enhanced service or new products."<sup>460</sup>

189. There are several criteria the Commission applies in deciding whether a claimed benefit should be considered and weighed against potential harms. First, claimed benefits must be *merger specific* – *i.e.*, the claimed benefits must be likely to be accomplished as a result of the merger but unlikely to be realized by other means that entail fewer anticompetitive effects.<sup>461</sup> As the Commission explained in the *Bell Atlantic/NYNEX Order*: "Efficiencies that can be achieved through means less harmful to competition than the proposed merger . . . cannot be considered to be true pro-competitive benefits of the merger."<sup>462</sup>

190. Second, claimed benefits must be *verifiable*. Because much of the information relating to the potential benefits of a merger is in the sole possession of the merging parties, those parties must provide sufficient support for any benefit claims so that the Commission can verify the likelihood and magnitude of each claimed benefit.<sup>463</sup> In this regard, the magnitude of benefits must be calculated net of

<sup>459</sup> See, e.g., *Bell Atlantic-NYNEX Order*, 12 FCC Rcd at 20063 ("Applicants bear the burden of showing both that merger-specific efficiencies will occur, and that they sufficiently offset any harms to competition such that we can conclude that the transaction is pro-competitive and therefore in the public interest."); *SBC-Ameritech Order*, 14 FCC Rcd at 14825 (same).

<sup>460</sup> *Bell Atlantic-NYNEX Order*, 12 FCC Rcd at 20063; see also *DOJ/FTC Guidelines* § 4 ("The Agency will not challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant market. To make the requisite determination, the Agency considers whether cognizable efficiencies likely would be sufficient to reverse the merger's potential to harm consumers in the relevant market, e.g., by preventing price increases in that market.").

<sup>461</sup> See, e.g., *Bell Atlantic-NYNEX Order*, 12 FCC Rcd at 20063 ("Pro-competitive efficiencies include only those efficiencies that are merger-specific, *i.e.*, that would not be achievable but for the proposed merger."); *SBC-Ameritech Order*, 14 FCC Rcd at 14825 ("Public interest benefits also include any cost saving efficiencies arising from the merger if such efficiencies are achievable only as a result of the merger. . ."); see also *DOJ/FTC Guidelines* § 4 ("The Agency will consider only those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects.")

<sup>462</sup> *Bell Atlantic-NYNEX Order*, 12 FCC Rcd at 20063

<sup>463</sup> See, e.g., *id.* at 20063 ("These pro-competitive benefits include any efficiencies arising from the transaction if such efficiencies . . . are sufficiently likely and verifiable. . ."); *SBC-Ameritech Order*, 14 FCC Rcd at 14825, (same); see also *DOJ/FTC Guidelines* § 4 ("[T]he merging firms must substantiate efficiency claims so that the Agency can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so), [and] how each would enhance the merged firm's ability to compete. . .").

the cost of achieving them.<sup>464</sup> Moreover, speculative benefits that cannot be verified will be discounted or dismissed. Thus, for example, benefits that are to occur only in the distant future may be discounted or dismissed because, among other things, predictions about the more distant future are inherently more speculative than predictions about events that are expected to occur closer to the present.

191. Third, benefits are generally counted only to the extent that they can mitigate any anticompetitive effects of the merger.<sup>465</sup> Since, in general, reductions in marginal cost are more likely to result in lower equilibrium prices, we will more likely find marginal cost reductions to be cognizable than reductions in fixed cost.<sup>466</sup>

192. Finally, the Commission applies a sliding scale approach to evaluating potential benefits, under which it will require applicants to demonstrate that claimed benefits are more likely and more substantial, the greater the likelihood and magnitude of potential harms. More specifically, "[a]s the harms to the public interest become greater and more certain, the degree and certainty of the public benefits must also increase commensurately in order for us to find that the transaction on balance serves the public interest. This sliding scale approach requires that where, as here, potential harms are indeed both substantial and likely, the Applicants' demonstration of claimed benefits also must reveal a higher degree of magnitude and likelihood than we would otherwise demand."<sup>467</sup>

193. As discussed below, the Applicants claim that the merger will generate three basic benefits relating to the MVPD market. First, they argue that the merger, by eliminating duplicative use of the limited DBS spectrum, will permit New EchoStar to use that spectrum more efficiently, thus permitting it to offer new and improved services to consumers, including local programming services in all 210 DMAs and other new video services, more HDTV channels and more VOD service.<sup>468</sup> Second, they claim that the merger will generate efficiencies and other cost savings that will result in lower prices to consumers. Finally, because of its lowered costs and larger effective spectrum capacity, the Applicants claim that New EchoStar will be a stronger competitor to cable than either EchoStar or DirecTV could be on its own.

#### 1. New Services

194. As previously discussed, the Applicants argue that the merger will greatly improve spectrum efficiency by eliminating substantial duplication of programming, which will allow the merged entity to offer new and better services to consumers.<sup>468</sup> According to the Applicants, these spectrum efficiencies will permit New EchoStar to offer local programming in all 210 DMAs.<sup>469</sup> In addition, they

<sup>464</sup> *DOJ/FTC Guidelines* § 4 ("Cognizable efficiencies are assessed net of costs produced by the merger or incurred in achieving those efficiencies.").

<sup>465</sup> See, e.g., *Bell Atlantic-NYNEX Order*, 12 FCC Rcd at 20063 ("Efficiencies generated through merger can mitigate competitive harms if such efficiencies enhance the merged firm's ability and incentive to compete. . .").

<sup>466</sup> See, e.g., *DOJ/FTC Guidelines* § 4 (noting that marginal cost reductions may lessen the likelihood or effectiveness of coordinated interaction (by enhancing the incentive of a maverick to lower price or by creating a new maverick firm) and also may reduce a merged firm's incentive to initiate a unilateral price increase.)

<sup>467</sup> *SBC-Ameritech Order*, 14 FCC Rcd at 14825 Cf. *DOJ/FTC Guidelines* § 4 ("The greater the potential adverse competitive effect of a merger . . . the greater must be cognizable efficiencies in order for the Agency to conclude that the merger will not have an anticompetitive effect in the relevant market. When the potential adverse competitive effect of a merger is likely to be particularly large, extraordinarily great cognizable efficiencies would be necessary to prevent the merger from being anticompetitive.").

<sup>468</sup> Application, Eng. Statement at 8-9.

<sup>469</sup> Applicants' Reply at 3-5