Direct Broadcast Satellite Service and Competition in the Multichannel Video Distribution Market: Hearing Before the H. Comm. on the Judiciary, 107th Cong., Dec. 4, 2001 (Statement of Robert Pitofsky, Prof. of Law, Geo. U. L. Center)

Robert Pitofsky
Georgetown University Law Center, pitofsky@law.georgetown.edu

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DIRECT BROADCAST SATELLITE SERVICE AND COMPETITION IN THE MULTICHLANNEL VIDEO DISTRIBUTION MARKET

HEARING
BEFORE THE
COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES
ONE HUNDRED SEVENTH CONGRESS
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Mr. PITOFSKY. Thank you, Mr. Chairman, Mr. Conyers. It is always a pleasure for me to appear before the Members of this Committee.

I would like to talk a bit about the antitrust problems, and then address some of the purported justifications for this deal. I will try to be brief about the problems, because I think Members of the Committee get it.
Let's divide the country up by those portions served by cable and those that are not. The Chairman mentioned that 30 percent of the people in Wisconsin don't have access to cable. That is not unusual; 30 to 50 percent of people in 20 different States don't have access to cable.

For those people, a merger of these two satellite companies is a virtual merger to monopoly, with high entry barriers, so no one else is going to come in to alleviate that condition.

Let's look at the rest of the country. It is true that the satellite companies will compete with cable companies. But do they also compete more directly and more fully with each other so as to justify their being in a separate market, so there, too, it is a merger to monopoly? And it seems to me that that could easily be the case.

The analogy, I would suggest, is between railroads and airlines. Railroads and airlines compete, for example, New York to Washington, Washington to New York, but that doesn't mean you let all of the airlines merge to monopoly. Because of their special prices, qualities, appeal to consumers, they are a separate market.

And, incidentally, that is not an argument that only I ascribe to. Mr. Ergen said many think that they are in a separate market. Well, that includes EchoStar, which just a year ago in a private case against DirecTV argued that EchoStar and DirecTV constrain each other's prices and cable is not an effective constraint of prices in that market.

Finally, even if I am wrong about all of this, it is still a three-to-two merger, and the Court of Appeals of the District of Columbia just a year ago when Beechnut and Heinz tried to merge in circumstances very similar to this, a larger number one, two and three said, we need the merger to compete, there were high entry barriers; and the court said, we have looked back and we can't find a single case in history—I think they meant 110 years—in which a merger of this type was allowed.

Those are the problems.

What are the justifications? First, is the trade-off argument. Yes, the people in rural America will sacrifice some competition, but it is worth it because it will improve competition in the rest of the country. My answer to that argument is simple. We don't do it that way.

The antitrust laws say, mergers that lessen competition in any market are illegal. And we don't trade off procompetitive effects in one market against anticompetitive effects in another. The Supreme Court could not have been clearer about this in Philadelphia National Bank and since.

Second, Mr. Ergen states, and I'm prepared to accept his claim, that there are real efficiencies to this deal. Well, first of all, there is a bipartisan consensus that efficiencies are easy to allege and hard to prove; and therefore you would want to look very carefully at the efficiency claims.

But let's assume that the efficiencies are there, and certainly some of them are there. But then the question is whether efficiencies justify a merger to monopoly or near monopoly. I have been one who has been more welcoming of efficiency defenses than almost anyone in our community; but I have always said, it doesn't
justify mergers to monopoly. The DOJ-FTC guidelines say it doesn’t justify mergers to monopoly.

What is the point of achieving all of those efficiencies if you are a monopoly? Where is the incentive then to pass the efficiencies on to consumers without a competitive market?

Finally and most interestingly, EchoStar suggests that the rural subscribers don’t have to worry because there is competition in the urban areas, and EchoStar will give others who are in areas not served by cable the same deal that they give to people served by cable, so they will get the benefits of something like competition.

It is interesting, it is novel, but I just don’t think it hangs together for four reasons. First, it puts the government in the position of doing something that the government hates to do, and that is review, monitor and check whether there is price discrimination from community to community to community throughout the United States.

Whenever I hear from the satellite companies, it is about special offers, free goods, 30 days free, et cetera. How do you reconcile all of that in every single city, many of which are quite different in terms of their income?

Second, that takes care of the price problem. I have less than a minute, Mr. Chairman.

But what about all of the other forms of competition—service, quality, reliability, technology? In an area like this, you want companies vigorously competing on the technological front.

Third, it is still a three to two merged at best in the urban areas. I would regard it as cold comfort if I were somebody who couldn’t get cable and was told, I will get the benefit of competition in other parts of the country when competition has been reduced from three firms to two.

Finally, lastly, this proposed merger raises a very fundamental question about what antitrust is all about. We have bet this country for over 100 years on a system of free market protected by antitrust in which independent rivals compete fiercely, as the satellite companies have done to advance consumer welfare, to improve their product, to lower their prices.

This is a proposal that we should trust well-intentioned people; they promise that they won’t overdo it, they won’t abuse the market power that this merger allows. We haven’t accepted that kind of argument in this country.

Now, maybe there is another deal that can be worked out here. Maybe DirecTV is leaving the market no matter what happens. But I have to say that this deal, as proposed, has very serious problems.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Pitofsky follows:]

PREPARED STATEMENT OF ROBERT PITOFSKY

Mr. Chairman, members of the Committee, I am pleased to appear before you today to present testimony concerning application of the antitrust laws to the proposed merger between EchoStar Corporation and G. M. Hughes Electronics, the parent company of DirecTV. I believe this merger raises profound issues for antitrust policy in both the telecommunications and media industries.

Let me disclose at the outset that I am now Counsel to the Washington law firm of Arnold & Porter, and the firm represents Pegasus, a distributor of DBS services
and therefore a company with a deep interest in the economic consequences of this merger.

EchoStar and DirecTV are today the only facilities based providers of direct broadcast satellite (DBS) services in the United States. Between them they control all three of the orbital slots licensed by the Federal Communications Commission for DBS service capable of serving the entire U.S. It seems to be a common understanding that no additional satellites are likely to be available for DBS service in the foreseeable future. Put another way, the barriers to entry into DBS service are virtually insurmountable. That was the reason that the Department of Justice, when it issued a complaint in 1998 seeking to block the acquisition by Primestar of an orbital slot then held by MCI and NewsCorp, alleged there was no feasible means of entry into the multi-channel video business in the near future. That statement is no less true today than it was in 1998.

The testimony before the Committee today has revealed that there are many issues of fact relating to this transaction. For example, there are claims that the proposed merger offers an opportunity for substantial efficiencies, and those efficiencies are likely to be passed on to consumers in the form of improved services. I am prepared to assume for the sake of this session that the people advocating the legality of this merger are well intentioned and credible and that their efficiency claims—while they will have to be carefully analyzed and confirmed—can be assumed for now to be true. Even on that basis, I offer my own conclusion that this transaction as presented faces serious—perhaps the more accurate description is insurmountable—antitrust problems.

It is helpful in thinking about the competitive and consumer effects of this proposed merger to consider its impact in different parts of the country. Today in many sections of the country—mostly rural but accounting for millions of subscribers—there is no cable television available. In other sections where cable is present, there are antiquated facilities that are unlikely to be upgraded in the foreseeable future so that cable is a limited competitor. In those areas, however, consumers do have the benefit of two DBS providers—DirecTV and EchoStar—which compete aggressively for consumer subscriptions through discounts, free equipment, improved service, and similar inducements. For subscribers located in those non-cable or limited-cable areas, this proposed deal is clearly a merger to monopoly, with the predictable higher prices and indifferent quality that experience demonstrates will follow in the wake of that level of market power. In rural areas, this merger does not "lessen competition," it completely eliminates it.

On October 30, a Wall Street Journal editorial took an unusual view of the plight of viewers in non-cable areas. It observed that "those who choose to live in a cornfield have no claim on the rest of the economy just to subsidize their entertainment options" and therefore presumably can be left to the mercy of a monopolist. Fortunately, the antitrust laws prevent mergers that lessen competition "in any section of the country." Even sections some in the press think are too unsophisticated to matter.

Those who would like to see the merger go through unchallenged are likely to argue that it is worthwhile giving up some competition in some parts of the country because the combined DBS outlets will be in a better position to compete with cable in other sections of the country. They argue that only DBS is in a position to challenge the high rates and less-than-perfect service offered by the huge cable companies. The argument is that in almost all sections today there is only one cable supplier and unhappy subscribers now have two alternative and competing DBS sources to consider. After the merger there will be only one DBS source. As a result, even if one concedes that DBS and cable are direct com-

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2. For example, a recent New York Times article estimated that 40-50% of homes in the following states are without cable access: Montana, South Dakota, Utah, Mississippi, Arkansas and Vermont. In other states, including Idaho, Wyoming, New Mexico, Oklahoma, Louisiana, Missouri, Idaho, Alabama, Tennessee, Kentucky, Virginia, North Carolina, Maine and Wisconsin, an estimated 30-40% of homes are without cable access. See Look, Up in the Sky! Big Business Gets a Shot at Small-Town Satellite, N.Y. TIMES, Oct. 30, 2001, at C1.
4. The key provision of Section 7 of the Clayton Act reads as follows: No person engaged in commerce or in any activity affecting commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no person subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another person engaged in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly. 15 U.S.C. § 18 (emphasis added).
Petitioners—a point that EchoStar challenged a litte more than a year ago in a private antitrust lawsuit—the merger would still result in a reduction of competitors from three to two with no prospect of new entry to alleviate that condition in the foreseeable future.

Let's assume, contrary to the forcefully stated views held by EchoStar just last year, that DBS and cable are in the same markets. There is a long history of the second and third firms in a three-firm market, with high barriers to entry, arguing that the combination will be better equipped to challenge the powerful number one.

That argument was advanced by Heinz and Beechutn a year ago when their merger, allegedly to put them in a position to compete more effectively with the dominant Gerber, was challenged by the FTC. A unanimous District of Columbia Court of Appeals enjoined the merger in language that applies almost perfectly to the proposed EchoStar-DirecTV deal:

"There have been no significant entries in the baby food market in decades and...[new entry is] difficult and improbable...As far as we can determine, no court has ever approved a merger to duopoly under similar circumstances." 6

In advocating a fundamental change in merger policy, defenders of the merger have advanced several arguments. I noted earlier the argument that even conceding a lessening of competition to consumers in rural America, that reduction is worthwhile in order to improve competition in the remaining parts of the country. That kind of tradeoff is often is suggested by those sponsoring a merger. In one of the first cases reviewed by the Supreme Court after Section 7 of the Clayton Act was amended and updated in 1950, two Philadelphia banks tried to justify a merger that would produce a high level of concentration in the local market on grounds that consumers in Philadelphia might be harmed, but the merger would allow the larger bank resulting from the merger to compete for very large loans with still larger out-of-state banks, particularly those located in New York. In language that the Court has adhered to consistently ever since, it rejected what it called a concept of "counterveiling power."

"If anticompetitive effects in one market could be justified by procompetitive consequences in another, the logical upshot would be that every firm in an industry could, without violating §7, embark on a series of mergers that would make it in the end as large as the industry leader." 7

Supporters of the merger also appear to argue that it will allow the combined firms to offer efficiencies to consumers, and with those efficiencies improved service. It will require fairly extensive investigation to determine the magnitude of any claimed efficiencies and also to address the question of whether those efficiencies could be achieved through means other than a merger between two direct competitors.

As noted earlier, I am willing to assume for purposes of this discussion that significant efficiencies may result. Nevertheless, under the Department of Justice-FTC revised Merger Guidelines, issued in 1997, and indicating for the first time a willingness on the part of federal enforcement officials to take efficiencies into account, any such efficiencies would not be adequate to justify what is an otherwise illegal merger that leads to monopoly or near monopoly. After explaining that mergers that produce high concentration can only be justified by exceptionally substantial efficiencies, and that there must be the likelihood that those efficiencies would benefit consumers and have little potential adverse competitive effects, the Guidelines note:

"In the Agency's experience, efficiencies are most likely to make a difference in merger analysis when the likely adverse competitive effects, absent the

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6 Among the many points cited by EchoStar in arguing that DBS is a separate product market from cable are the following: a) A significant number of DBS subscribers view DirecTV and EchoStar as significantly closer substitutes than alternative sources of programming, including cable television; b) If not constrained by EchoStar, DirecTV could raise its prices above the competitive level without experiencing a significant constraint by cable; c) DBS and/or High Power DBS is superior to most cable services in several respects, including a higher quality picture, substantially more programming options, and pay-per-view in a "near-on-demand" environment that consumers find more attractive than the pay-per-view environment offered by cable. See Memorandum of Law in Support of Request for Rule 56 Continuance to Respond to DirecTV Defendants' Motion for Summary Judgment at 11–12, EchoStar Communications Corp. v. DirecTV Enters., Inc., No. 00-K-215 (D. Colo. filed Nov. 6, 2000).


efficiencies, are not great. *Efficiencies almost never justify a merger to mono-
nopoly or near-monopoly.* ⁸ (Italics added.) ⁹

Let me elaborate briefly on the point. The reason the DOJ/FTC Merger Guidelines
were amended to permit efficiency claims is that efficiencies generated by merger
may enhance the merged firms ability and incentive to compete, and may result in
lower prices, improved quality, enhanced services or new products. But the whole
idea is that these efficiencies would then be likely to be passed on to consumers.
If the merger leads to monopoly or a near monopoly, there is no reason for the firms
not to decide to pocket the gains that result from no longer competing with each
other. Thus, even under a liberal interpretation of the role of efficiencies in merger
enforcement, they would not be sufficient to save the kind of illegal transaction pro-
posed by EchoStar and DirecTV.

Finally, advocates of the proposed merger have advanced a most unusual argu-
ment. They suggest that for most of the country the combined DBS company will
have to compete with cable, and competition with cable will keep the DBS rates
competitive. They also have promised not to discriminate between rates and terms
offered in cable and non-cable areas, so that subscribers in rural areas, faced with a
monopoly, would not have to pay monopoly rates.

There are several problems with that argument. First, it leaves the government
in the position of monitoring rates and complicated terms in every community to
guard against discrimination—a role that the government tries not to play in a free
market economy—certainly not when the transaction is a horizontal merger to mo-
nopoly or near monopoly. Second, even if the price terms are worked out, that says
nothing about the loss of competition in non-price dimensions—including customer
service, programming packages, advanced services and, in particular, technological
competition. In a high-tech, dynamic, rapidly developing field like video program-
ming delivery, competition in terms of quality and technology is particularly im-
portant. Third, if the merger reduces competition in urban markets, and reducing com-
petitors from three to two certainly suggests such a threat, there is little comfort
in pegging prices in rural areas to what may be less-than-competitive prices in
urban areas. Most important, the suggestion that mergers to monopoly and duopoly
should escape challenge if the merged companies promise not to abuse their market
power is fundamentally inconsistent with U.S. antitrust enforcement. We depend on
vigorous competition among rivals to produce reasonably priced and high quality
products. The idea of substituting for competition the promises of the most sincere
captains of industry is simply not the philosophy that we have pursued consistently
in this country.

The proposed merger also raises troubling issues in the emerging broadband mar-
ket—that is the provision of upgraded high-speed access to the Internet. In a series
of proceedings—including those occasioned by the AOL/Time Warner merger⁷ and
the AT&T/Time Warner merger⁸; the Antitrust Division, the FTC and the FCC have
all sought to preserve competition in this extremely important new market. Con-
gress has also been concerned that megamergers not lead to a situation in which
high-speed access to the Internet will come under the control of one or a small hand-
ful of companies. This merger would threaten a potential monopoly in satellite
broadband service.

Wired broadband technologies, such as cable and telephone connections (“DSL”) have been slow to emerge in rural areas for many of the same reasons that these
areas have limited cable penetration. There is not sufficient demand to insure more
rapid deployment. Satellite broadband service provides the most viable technology
that can bridge the digital divide in rural America. As noted, the merger of
EchoStar and DirecTV would be a merger to monopoly for millions of rural con-
sumers who, both today and tomorrow, have no alternative to DBS for broadband
Internet as well as multi-channel video service.

Here, too, the merging parties argue that the merger, by increasing capacity and
eliminating “duplication,” will enable them to devote more capacity to rolling out

⁷U.S. Department of Justice and Federal Trade Commission, REVISIONS TO HORIZONTAL
Reg. 78561 (FTC Dec. 20, 2000); In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations by Time Warner Inc. and America Online,
for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from MediaOne Group, Inc., Transferor to AT&T Corp. Transfers, 15 F.C.C.R. 9618 (FCC June 6,
2000).
broadband services. But the “duplication” they seek to eliminate is competition itself. Moreover, they would have to bear the burden of showing why the increase in capacity this merger would produce is necessary to bring out the services that both DirecTV and EchoStar have promised consumers for some time that each separately would provide.11

The aim of antitrust merger enforcement is to protect consumers from the abuses that follow from extreme concentration of market power. As proposed, the EchoStar-DirecTV merger certainly raises that threat, and consumers are left with CEO promises (and perhaps hard to enforce conduct remedies) to protect against abuses. It may be that DirecTV is determined to exit the market—as it has every right to do. But without a facilities-based structural remedy that insures that consumers have roughly the same options they have now, this merger should not be permitted.

Chairman SENSENBRaNNER. Robert Phillips, president and CEO of the National Rural Telecommunications Cooperative.

TESTIMONY OF BOB PHILLIPS, PRESIDENT AND CEO, NATIONAL RURAL TELECOMMUNICATIONS COOPERATIVE

Mr. PHILLIPS. Thank you, Mr. Chairman. And good morning, Ranking Representative Conyers and other Members of the Committee. It is a privilege to appear before you today to represent the views of the National Rural Telecommunications Cooperative, or NRTC, regarding the proposed merger of EchoStar and DirecTV, and its impacts on the multichannel video distribution market.

NRTC believes that this merger, as proposed, is bad for competition in rural America because it creates a rural monopoly, it eliminates choice, and it eliminates competition.

From our founding in 1986 it has been NRTC’s focus to bring advanced rural telecommunications services to all of those who live and work in rural America. NRTC has also been involved in the satellite television business, starting with large-dish satellite service, or C-band, including our own investment of our members and utilities in excess of $100 million to help launch the DirecTV service.

Today, NRTC, through its participating members, who are rural electric cooperatives and rural telephone cooperatives and companies as well as affiliates like Pegasus satellite, serve more than 1.8 million rural subscribers with DirecTV.

As I said, this merger does eliminate competition for rural consumers. Literally millions of rural homes have no access to cable television or digital cable television services. That makes satellite their only option for video programming.

And I did bring a map today which is a blow-up of the chart which I included in my testimony, showing on a state-by-state basis how tens of millions of people have no choice for video programming other than satellite.

Today, these consumers can choose between EchoStar’s dish service or DirecTV. If this merger is approved, their choices go from those two providers to one. The proponents of this two to one merger argue that promises will suffice for competition and that the

11 For example, an expert retained by the DOJ in a recent case regarding the constitutionality of must-carry provisions in the Satellite Home Viewer Improvement Act opined that both EchoStar and DirecTV could use currently available technology to significantly increase their ability to provide local programming to additional markets. See Declaration of Roger J. Rusch, Satellite Broadcasting & Communications Ass’n v. FCC et al., No. 00-1571-A (E.D. Va. dated May 23, 2001). If the DOJ’s expert is correct, one of the principal efficiencies advanced by EchoStar and DirecTV in support of their merger could be achieved by either company alone. Efficiencies achievable by less anticompetitive means do not justify a merger to monopoly or near monopoly.