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Dominance in the Sky: Cable Competition and the EchoStar-DIRECTV Merger: Hearing Before the S. Subcomm. on Antitrust, Business Rights and Competition, 107th Cong., Mar. 6, 2002 (Statement of Robert Pitofsky, Prof. of Law, Geo. U. L. Center)

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**DOMINANCE IN THE SKY: CABLE COMPETITION
AND THE ECHOSTAR-DIRECTV MERGER**

HEARING
BEFORE THE
SUBCOMMITTEE ON ANTITRUST,
BUSINESS RIGHTS, AND COMPETITION
OF THE
COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE
ONE HUNDRED SEVENTH CONGRESS
SECOND SESSION

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MARCH 6, 2002
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illumination by which to see with increased clarity what is best for those we serve, those who are watching or surfing at home, those who will live with the effects of this merger as they seek out information and entertainment for themselves and for their families.

Chairman KOHL. Thank you, Senator Hatch.
Now, we turn to Mr. Pitofsky.

**STATEMENT OF ROBERT PITOFSKY, FORMER CHAIRMAN,
FEDERAL TRADE COMMISSION, WASHINGTON, D.C.**

Mr. PITOFSKY. Thank you, Mr. Chairman and members of the Committee. As always, it is an unusual pleasure for me to appear before this particular Committee.

I would like to treat this discussion a little differently. I am going to be very brief on the question of whether this merger on the surface violates the antitrust laws because on the surface it is about as illegal as a merger gets to be and I would really like to spend my time talking about the fixes that have been proposed.

Just briefly, in something like 19 or 20 percent of the country it is a merger to monopoly, and the statute clearly says that that should be prevented. Nineteen States, something over 30 percent of subscribers, have no access to cable, so it is a two-to-one merger.

In areas served by cable, it is still a three-to-two merger, and we just had that case in the court of appeals last year when Beechnut and Heinz tried to merge, claiming they would be better competitors. Not only did the court turn down that merger, but they said in the long history of antitrust we can't find a single case in which that kind of merger was allowed where there are high barriers to entry.

So what is the fix? Well, first, the argument which I don't hear as much today but I have heard: we will lose competition in rural America, but that is a price you have to pay; it will prove competition in the rest of the country. Well, that flies in the face of the plain language of the statute, which says do not allow a lessening of competition in any section of the country. I think 20 States, 20 percent of the people here in the country, is a section of the country. And the Supreme Court has addressed that question and they just won't do tradeoffs like that; they don't think it is justifiable.

Second, here is the real claim: If we can merge, there will be efficiencies and those efficiencies will allow us—monopoly is more efficient than competition and will allow us to do things that competition won't allow us to do. But, you know, the main point is why can't these two companies do it on their own?

Senator Hatch just pointed out they suddenly came up with a way to serve 210 cities instead of 40 or 100. This merger will be permanent if it goes through. Technology is not permanent. These companies have gone from 1 million subscribers to 17 million subscribers in just 5 or 6 or 7 years. They have improved the technology of their product enormously. They deserve tremendous credit.

Why can't they do that separately? Why do they need the merger to monopoly or duopoly to achieve those things? Several witnesses before the FCC said, under present technology, they could serve all these local markets today. And even if they can't today, what will we see shortly after that, in a year, 2 years, something like that?

Finally, there is this very unusual argument that rural America will not be disadvantaged because there will be a national list price and people will pay the same price in Montana or Vermont as they will in New York and Los Angeles. Well, first of all, there is more to competition than list prices. What about service, subsidies, packages, improvements in technology? We are merging to monopoly. Usually, one expects that that kind of competition will disappear or be diminished. Also, if I lived in rural America and was told I will have the benefit of getting the kind of prices that people are paying for cable in urban America, I wouldn't be enthusiastic about that.

We want competition to decide prices and terms and service. We don't want monopolists to do so. I can't help suggesting the following analogy. After this deal goes through, suppose the airline companies come in here and they say all that duplication that comes from competition; let United Airlines, American and Delta all merge together and we will serve more cities if the three of us are together than we can today. I mean, it is almost ludicrous, but that is very similar to the argument that is being presented.

Finally, and briefly, I think there is more to this matter than the welfare of consumers in urban or rural America. We have seen incredible deregulation by Congress, by the courts, and by the FCC. Much of that is a good thing. Many of those old rules were obsolete and outdated. But every time we get rid of one of those rules, the argument is, yes, but antitrust is there to take care of preserving a diversity of markets, access to those markets, diversity of ideas, and so forth.

If antitrust is asleep at the switch on a merger to monopoly, what signal does that send to the other media companies about what is acceptable and what can be done as long as the parties say we won't abuse our market power and they claim that monopoly is more efficient than competition? That is not the philosophy this country has followed.

Thank you.

[The prepared statement of Mr. Pitofsky follows:]

STATEMENT OF ROBERT PITOFSKY, FORMER CHAIRMAN OF THE FEDERAL TRADE COMMISSION, WASHINGTON, D.C.

Mr. Chairman, Members of the Committee, as in the past I am pleased and privileged to have an opportunity to testify before this Committee. Today I will address the question of the application of the antitrust laws to the proposed merger of EchoStar Corporation and Hughes Electronics, the parent company of DIRECTV. Hearings on this subject before this Committee are most timely since I believe the proposed merger raises very important questions about the direction of antitrust enforcement in this country.

I want to disclose at the outset that I am both a Professor of Law at Georgetown University Law Center and Counsel to the Washington law firm of Arnold & Porter. That law firm represents Pegasus, a distributor of direct broadcast satellite ("DBS") services, and a company that has publicly indicated its deep interest in the competitive and economic consequences of the merger. Nevertheless, I appear today in my individual capacity and not as a representative of any corporate interest.

EchoStar and DIRECTV are today the only facilities-based providers of DBS services in the United States. Between them they control all three of the Ku band orbital slots licensed by the Federal Communications Commission that provide DBS service to the full continental United States. It seems to be commonly accepted that no additional Ku band orbital slots are likely to be available for DBS service in the foreseeable future.

DIRECTV and EchoStar are thriving companies that have expanded their base substantially in recent years. Between them they have a total of 16.7 million subscribers—up from less than a million subscribers in 1994.¹ The growth rate of each company has been phenomenal—for example, in just the last year, EchoStar's annual subscriber rate increased by 40% and DIRECTV's rate increased by 15%.² Much of that growth rate has been accomplished as a result of fierce competition between the two companies and, in parts of the country that have access to cable, also between each company and cable. Competition between the two DBS companies has occurred through discounts and dealer promotion programs, subsidized equipment, improved service and similar inducements. It is interesting that the key innovations in video programming delivery—such as on demand access to movies and comprehensive sports packages—have been driven by DBS competition between EchoStar and DIRECTV.

I find it 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 cable television is not available. Although the merger parties claim that only a small percentage of homes are without access to cable, other sources indicate that the percentage of homes without cable access might be as high as 19%.³ In Montana, South Dakota, Utah, Mississippi, Arkansas and Vermont, it has been reported that 40% to 50% of homes are without cable access; in Idaho, Wyoming, New Mexico, Oklahoma, Louisiana, Missouri, Idaho, Alabama, Tennessee, Kentucky, Virginia, North Carolina, Maine and Wisconsin, an estimated 30% to 40% of homes are reportedly without cable access.⁴ Even in areas where cable is available, it is often unsophisticated analog rather than digital cable and some subscribers have demonstrated a preference for DBS service over sometimes antiquated cable facilities.

For subscribers located in these non-cable or limited-cable areas, this proposed deal is a merger to monopoly, with the predictable higher prices and indifferent quality that experience shows will follow in the wake of that level of market power. In many rural areas, this merger does not "lessen competition," it completely eliminates competition.⁵

I am aware of arguments that it is worthwhile to see a reduction in competition for consumers in rural America because it will improve competition in the remaining parts of the country. Specifically, it has been argued that the combined EchoStar-DIRECTV will be in a better position to compete with the large cable companies. That is an argument that contradicts the plain language of Section 7 of the Clayton Act which outlaws a lessening of competition "in any section of the country."⁶ In one of the earliest cases reviewed by the Supreme Court after Section 7 was amended in 1950, two large banks in Philadelphia tried to justify a merger by arguing that consumers in the local market might be disadvantaged, but that would be more than outweighed by the fact that the larger bank, with higher lending limits because of size, could compete with the big New York banks in loans and other activities throughout the United States. The Court rejected what it called a concept of "countervailing power," explaining as follows:

"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 Section 7, embark on a series of mergers that would make it in the end as large as the industry leader."

¹ See *In re Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Eighth Annual Report, ¶ 57 (Jan. 14, 2002).

² *Id.*

³ See National Telecommunications and Information Administration (NTIA) & Rural Utilities Service (United States Department of Agriculture), *Advanced Telecommunications in Rural America: The Challenge of Bringing Broadband Service to All Americans*, at 19 & n.62 (April 2000).

⁴ See *Look, Up in the Sky! Big Bets on a Big Deal*, New York Times, Oct. 30, 2001, at C1.

⁵ Moreover, that competition has been extremely valuable to consumers. For example, when EchoStar entered the market in 1996, offering serious competition to DIRECTV for the first time, DBS systems fell in price from the \$600 to \$800 range to \$200. See Mark Robichaux, *Who's News: EchoStar Chief Must Build Link to Murdoch Wall St. J.*, Feb. 26, 1997. DBS service prices, largely as a result of direct competition between 1996 and 2000. See *In re Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992*, Report on Cable Industry Prices, 16 FCC Rcd. 4,346 (2001).

⁶ Section 7 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 . . . 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).

Let me turn now to a second major argument offered by the sponsors of the merger—that DBS competes in a broader market that includes cable television and the merger would strengthen DBS as a competitor of cable.⁷

That whole approach is an interesting change of strategy for EchoStar since it filed a complaint in 2000 against DIRECTV in federal court in Colorado alleging that DBS is a relevant market, distinct from cable, and that no firm other than EchoStar or DIRECTV was likely to enter the market because of high entry barriers.⁸ Among the many points cited by EchoStar in arguing that DBS is a separate product market from cable was that a significant number of DBS subscribers view DIRECTV and EchoStar as closer substitutes than alternative sources of programming, including cable; if not constrained by EchoStar, DIRECTV could raise its prices above the competitive level without experiencing a significant constraint by cable; and DBS and/or high powered DBS is superior to most cable services in several respects.⁹

Contrary to EchoStar's views of just over a year and a half ago, EchoStar now asserts that DBS and cable do compete in the same market. If the merger goes through, however, that still means that the number of significant competitors will be reduced from three to two. Subscribers today who are dissatisfied with their cable service have two vigorous DBS competitors to turn to but would have only one as a result of the proposed merger.

The argument that two competitors is better than three if a strengthened number two can compete more effectively with the market leader was advanced just a year ago by Heinz and Beechnut when their merger, allegedly to put them in a position to compete more effectively with the dominant Gerber, was challenged by the Federal Trade Commission. A unanimous District of Columbia Court of Appeals enjoined the merger, noting in passing that it would be unprecedented to permit that level of concentration:

"[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."¹⁰

I suggest that the argument that it is acceptable to allow a merger to monopoly in some parts of the country, or even that it is acceptable to allow a merger from three firms to two where there are high barriers to entry, in order for the combined firm to compete more effectively with the market leader, would be a major departure from established law in this country. Moreover, there is no reason to believe that given their past success and present trajectory, each company, along with challenging each other, can not continue to take subscribers away from cable.

To summarize this point, if the proposed merger is permitted, it will be a merger to monopoly in areas of the country not presently served by cable—mostly rural America. As a result, existing competition on price and service, programming packages and, perhaps most important, in improving technology would disappear. In areas of the country served by cable, sources of programming would be reduced from three to two, price competition between EchoStar and DIRECTV which has kept prices low would disappear, and because of high entry barriers no new players are likely to appear. Under well established antitrust principles—recently emphasized by a unanimous DC Court of Appeals decision blocking the Beechnut/Heinz merger just last year—three to two mergers with high barriers to entry, and when neither company is failing, have never been allowed under the antitrust laws.

The parties recognize the difficulty of justifying this proposed merger and therefore have asserted several additional defenses—one common and the other most unusual—in an effort to justify the transaction. The common claim by sponsors of the merger is that it will allow the combined firm to offer efficiencies to consumers and with those efficiencies improve service. Most of the efficiencies that have been described, however, really come down to elimination of duplication and overlap. But that is just a roundabout way of justifying the elimination of competition. Another efficiency that I have heard mentioned is that a broader spectrum would allow satellite carriers to offer more local TV stations in more local markets. But a consultant to the Department of Justice (and now a Pegasus consultant), Roger J. Rusch, concluded that EchoStar and DIRECTV, using currently available technology, could

⁷ *United States v. Philadelphia National Bank*, 374 U.S. 321 3790 (1963).

⁸ Complaint, *EchoStar Communications Corp. v. DIRECTV Enters. Inc.*, Civ. Action No. 00-K-212 (D. Colo., filed February 1, 2000).

⁹ 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-212 (D. Colo., filed Nov. 6, 2000).

¹⁰ *Federal Trade Commission v. H.J. Heinz Co.*, 246 F.3d 708, 717 (DC Cir. 2001).

each, on its own, achieve the same service.¹¹ Other parties submitting petitions to the FCC have reached the same conclusion.¹² Moreover, just last week the merger parties announced that they had developed a new proposal that would allow them to deliver local channels to all 210 markets.¹³ The burden of persuasion that the two merging parties could not individually achieve the same services should be very great. Finally, even if there are cognizable efficiencies, the Department of Justice/FTC Revised Merger Guidelines, issued in 1997, explained that mergers that produce high concentration can only be justified by exceptional, substantial efficiencies, and that even such efficiencies "almost never justify a merger to monopoly or near-monopoly."¹⁴

There are persuasive reasons why mergers to monopoly should not be justified by claimed efficiencies. The law has eased on allowing efficiency justifications for mergers because it is now understood that such efficiencies could be passed on to consumers—not just pocketed by the officers and shareholders of the merging company. But if a merger leads to monopoly or near-monopoly, there is no reason for the firms to pass along these efficiencies since they no longer compete with each other.¹⁵

Finally, advocates of the proposed merger have advanced an unusual argument. 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 are willing to commit 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. I suggest that national pricing is no substitute for present vigorous competition. 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. How would the government monitor different offers in each city in the United States that subsidize the purchase of equipment, offer free or discounted installation, and provide promotional pricing and introductory offers? Second, even if price terms are worked out, that says nothing about the loss of competition in non-price dimensions—competition for programming, offers of programming packages, better service and, in particular, technological competition. In a high-tech, dynamic, rapidly developing field like video programming delivery, competition in terms of quality and technology is particularly important. Third, if the merger reduces competition in urban markets, and reducing competitors from three to two certainly suggests such a threat, there is little comfort in pegging prices in rural areas to what may turn out to be less-than-competitive prices in urban areas. As noted previously, cable prices have increased in this country 7% a year since 1996,¹⁶ and have not declined despite the presence of two aggressive DBS providers. Why would they come down in the future when there is only one competing provider? Should there be much satisfaction in rural markets to know that in the future they can have the benefit of price levels imposed on cable subscribers in urban markets in recent years? 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—not promises by merging parties or enforcement by government agencies.

The proposed merger also raises issues in the merging broadband market—that is the provision of upgraded high-speed access to the Internet. 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 ensure more rapid wire develop-

¹¹ Mr. Rusch filed an affidavit in support of Pegasus' opposition to the merger. See Affidavit and Report of Roger J. Rusch to Pegasus Communications Corporation's Petition to Deny, *In re Consolidated Application of EchoStar Communications Corp., General Motors Corp., Hughes Electronics Corp., Transferors, and Echo Star Communications Corp., Transferee, For Authority to Transfer Control* (FCC, filed Feb. 4, 2002).

¹² See, e.g., Petition to Deny of National Association of Broadcasters, at 74–81, *In re Consolidated Application of EchoStar Communications Corp., General Motors Corp., Hughes Electronics Corp., Transferors, and EchoStar Communications Corp., Transferee, For Authority to Transfer Control* (FCC, Filed Feb. 4, 2002); Petition to Deny By the National Rural Telecommunications Cooperative, at 56–60, *In re Consolidated Application of EchoStar Communications Corp., General Motors Corp., Hughes Electronics Corp., Transferors, and EchoStar Communications Corp., Transferee, For Consent For a Proposed Transfer of Control* (FCC, Filed Feb. 4, 2002).

¹³ EchoStar/Hughes Joint Press Release, *Merged EchoStar and Hughes will Deliver Local Broadcast Channels to All 210 U.S. Television Markets* (Feb. 26, 2002).

¹⁴ United States Dep't of Justice and Federal Trade Commission, *Revised 1992 Horizontal Merger Guidelines*, § 4 (rev. 1997), reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13, 104.

¹⁵ See *Id.*

¹⁶ See, *infra*, n.5.

ment. At least for the foreseeable future, satellite broadband service is the most likely technology to provide broadband in rural America. The merger of EchoStar and DIRECTV would be a merger to monopoly for millions of rural consumers who have no alternative to DBS for broadband Internet access as well as multi-channel video service.

I assume the parties will argue again that they need the merger to eliminate "duplication" and thereby will be able to roll out broadband service more quickly. The companies should certainly be pressed to explain why the merger is necessary to bring out services that both DIRECTV and EchoStar have promised consumers for some time that each would separately provide.

CONCLUSION

We see evidence on all sides of the amazing transformation of media in this country—partly a result of advances in technology but also a consequence of deregulation by Congress, the courts and the Federal Communications Commission. I agree that many regulatory rules are outdated and deserve to be vacated. With respect to the loosening of ownership restrictions, however, it is often said that antitrust is adequate to protect the market against undue concentration. Antitrust, it is argued, would prevent adverse effects on consumer welfare and preserve a marketplace open to a diversity of ideas.

If antitrust were to falter, media would indeed be a deregulated sector of the economy. This proposed merger of two satellite companies, resulting in monopoly in a substantial part of the United States and, at best, duopoly in the remainder, violates all of the established principles of merger review under the antitrust laws. If this merger as presently structured is allowed, antitrust will have faltered. An essential condition for continued deregulation will be absent. It would send a clear signal to other media companies that the net is down and almost anything goes—so long as the sponsors of the merger claim that their monopoly is more efficient than competition, and promise not to abuse their market power.

Chairman KOHL. We thank you, Mr. Pitofsky.
We turn now to Mr. Gene Kimmelman.

STATEMENT OF GENE KIMMELMAN, CO-DIRECTOR, WASHINGTON, D.C. OFFICE, CONSUMERS UNION, WASHINGTON, D.C.

Mr. KIMMELMAN. Thank you, Mr. Chairman, Senator DeWine, Senator Hatch. On behalf of Consumers Union, the online and print publisher of Consumer Reports, I appreciate the opportunity to testify once again.

As you know better than anyone, I believe no one has come before this Committee more often in the last 4 years to complain about consolidation and concentration of control in the media and telecommunications markets. And I could do this one exactly the same way, and both Mr. Nixon and Mr. Pitofsky make important antitrust points, and but I believe it would be more fruitful today to view this merger from a much broader perspective than just antitrust, but I will include antitrust.

For about 90 percent of consumers, the problem with television is cable monopoly. I appreciate that you have asked the GAO to study the impact of local broadcast channels added to satellite competing versus cable. We have looked at that and we will talk to the GAO, and the answer is quite clear and we have outlined it in great detail in our testimony. These are predominantly separate markets.

Even with local broadcasts, you have cable rates up 36 percent since 1996, when the Telecom Act was passed, and just since January of this year, from Seattle, to Los Angeles, to Reno, to Austin, to St. Louis, to Memphis, to Atlanta, to Syracuse, to Boston, double-digit cable rate increases. Most of those communities have sat-

Response of Robert Pitofsky to a question submitted by Senator Edward Kennedy

Question: What impact, if any, would approval of the proposed merger have on efforts to bridge the digital divide by providing greater high speed internet access to underserved urban and rural communities?

Answer: For many communities in the United States without access to cable or DSL, satellite broadband is the most likely option for the foreseeable future for their obtaining high-speed Internet access. I have seen no indication, however, that this merger is necessary to increase the availability of such satellite broadband services. Subsidiaries of both EchoStar and DirecTV are currently providing those services and have announced plans to expand those services. Consumers would be better off with two providers of satellite broadband services rather than one.

Responses of Robert Pitofsky to questions submitted by Senator Strom Thurmond

Question 1: Mr. Pitofsky, assuming that a merger between EchoStar and Hughes DIRECTV would result in enhanced competition between satellite and cable services in the short run, what will be the long-term effects on competition in the multi-channel video programming market? Are any short-term benefits worth the long-term risks? If the merger takes place, how can we be assured that a competitive market will exist ten years from now?

Answer: EchoStar and DirecTV have been doing very well on their own in competing against cable services. They claim they cannot be effective in their competition with digital cable without a merger, but it is hard to see why that would be true. Their record of success over the last six years undermines that argument. As a result, even in the short term, there is every reason to believe that existing competition between the two satellite providers will continue to serve consumers well.

With respect to the long term, if the merger is permitted, it is permanent. We could see a single satellite company dominating consumer services in this area for a long time—with the indifferent service and higher prices that high levels of market power usually produce.

Question 2: Mr. Pitofsky, it has been suggested that the "one nation, one rate card" will protect rural markets where cable services are not available, thereby preventing the new corporation from abusing its monopoly in multi-channel video programming in those areas. However, if a cable provider in a metropolitan area cuts prices drastically, the new corporation would be unable to lower the rates in that metropolitan area without lowering rates everywhere in the nation. Therefore, while rural areas would be protected, the new company would be unable to compete in the metropolitan areas where cable cuts its rates. If this merger is approved, won't the concept of "one nation, one rate card" be a hindrance to vibrant competition in some markets?

Answer: I believe the premise of your question is exactly right. The concept of a national rate card seems appealing only so long as one does not carefully examine the consequences. If there is a single rate card and a cable company were to cut prices in a particular area, the merged firm will only be able to meet those prices if it lowered its national rate card across the entire country. That is unlikely to happen. Also, the concept that competition comes in a single form—a single national rate card—is not consistent with experience. The satellite companies have aggressively competed with each other through new subscriber promotions, equipment discounts, and other incentives. Thus, even if the rates in rural areas where the combined company would have a monopoly were the same as elsewhere in the United States, the rural areas could be denied all of these inducements and concessions that have been so important in the DBS industry. Nor will a national rate card substitute for the loss in competition to offer new services and technological innovation.

There is also the question of who will monitor this unusual commitment by the merged firms. One possibility is just to take their word for it, but antitrust enforcement doesn't usually work that way. The alternative is for a government agency to monitor each and every term of sale in each and every community in the United States to ensure that the "one nation, one rate card" concept is being respected. That is a form of direct and intrusive government regulation in the media area that Congress, the FCC, and the courts have been trying to avoid.

Question 3: Mr. Pitofsky, if the Department of Justice were to approve the merger, what kind of safeguards should be implemented to ensure that prices are kept constant in those rural areas without access to cable? Can these safeguards be effective?

Answer: As I said in my previous answer, the kind of monitoring that would be required may be impractical and ineffective, and certainly is inconsistent with the general thrust of antitrust law in relying on the free market to ensure fair and non-discriminatory prices.

Question 4: Mr. Pitofsky, what safeguards are necessary to prevent the new corporation from requiring consumers to erect two dishes so that they may receive local channels? Would these safeguards be effective? If two dishes were eventually required, would many local channels be relegated to second-class status?

Answer: The question raises the very legitimate concern that the merger may produce inefficiencies in the way DBS service is provided. I don't have the technical expertise to know whether it will be necessary for consumers to purchase and own two satellite dishes rather than one, but the main point is that either of these companies separately could provide local TV channels. They are doing it now, and they are expanding. I see no reason why a merger is necessary to achieve that service—assuming willing consumers are available to purchase the service.

Question 5: Mr. Pitofsky, will the concentration of all the satellite spectrum in one company be a benefit or a detriment to consumers?

Answer: The theory of antitrust in this country for over 100 years is that monopoly market power in the long run is bad for consumers. That is particularly true where the market is barricaded by high entry barriers so that, if the monopolist raises prices or reduces service, others cannot enter. That is the situation that consumers would face if the proposed merger goes through.

Question 6: Mr. Pitofsky, are satellite services currently competitive with digital cable services? If so, does this undercut the argument that the merger is necessary for satellite to be competitive with cable?

Answer: I believe that satellite services are currently competitive with digital cable services in terms of the number of channels, quality of reception, advanced services that can be available to consumers and other features. Even if that were not true, this is an exceptionally dynamic sector of the economy, and services are modified and improved constantly. The real threat to continued competition would occur if EchoStar and DirecTV were permitted to merge so that they would amount to a satellite monopoly. Then the rivalry between the two, which has led to such obvious success in dramatic subscriber growth and expansion and enhancement of service in recent years, would disappear.

Question 7: Mr. Pitofsky, a guiding principle in American antitrust policy is the effect of a proposed merger on the consumer. How will the consumer of multi-channel video programming be affected by a merger between EchoStar and Hughes DirecTV?

Answer: It is the most fundamental tenet of American antitrust enforcement that mergers to monopoly (or even duopoly) will lead to higher prices, poorer service, and less innovation than would occur if there were competition. Congress and the courts have never wavered from their commitment to a free market protected by competition. I understand that the shareholders of the two companies proposing to merge might be enriched, but I simply can't see how consumers would be any better off.

Responses of Robert Pitofsky to questions submitted by Senator Herbert Kohl

1. Mr. Pitofsky, in most markets, the EchoStar/DIRECTV merger will reduce the number of competitors for subscription TV from three—the local cable TV company and the two satellite companies—to two. In rural areas not served by cable, the reduction to competition will be even worse—from two to one. Can you identify any merger in which a reduction in the number of competitors from three to two benefited consumers?

Answer: I cannot. Indeed, the Court of Appeals for the District of Columbia could not in the proposed merger of Beech Nut and Heinz, where it said it could not find a single case in which a merger of three to two under similar circumstances was permitted by a court. The result might be different if one of the two companies were failing or if barriers to entry into the market in which they operated were extremely

low. Neither of those factors is present in connection with the proposed EchoStar/DirecTV merger.

Question 2: Mr. Pitofsky, there is no doubt that consumers are upset—and rightfully so—by the seeming unending increases in the price of cable TV. EchoStar and DIRECTV claim that, by permitting them to bring local-into-local service into many more markets, this merger will greatly strengthen [satellite] as a competitor to cable and, in turn, restrain cable rates. What's your view of this issue? Won't this merger make satellite TV a much stronger competitor to cable, and therefore much better able to restrain cable rate increases?

Answer: It is hard to see why any of the alleged advantages of the merger could not be achieved by each of these companies separately—continuing to compete vigorously with each other. Experience suggests that where there is a three-to-two merger, the result will be to raise the price of the two smaller companies rather than lower the price of the dominant market leader.

Responses of Robert Pitofsky to questions submitted by Senator Orrin G. Hatch

Question 1: Attorney General Nixon, Mr. Fritts, and Mr. Pitofsky, would each of you please explain your respective interpretations of the recent announcement by DirecTV and EchoStar that they have suddenly found sufficient spectrum to carry all stations in all 210 television markets?

Answer: Of course it would be a welcome development if the DBS providers would provide local-into-local service to all consumers throughout the country. But the burden is on the merging parties to make a showing that the merger will result in efficiencies that are not achievable by each company independently, and that any efficiencies outweigh the concerns about extreme increased concentration. I have yet to see any persuasive evidence that these companies will not get to full local-into-local service on their own. Their essential argument appears to be that they would make more money if they didn't have to compete with each other, and that is a reason to allow the merger. That certainly is not a theory that results in consumer benefits.

Question 2: Attorney General Nixon and Mr. Pitofsky, let me ask you both a question that touches on a couple of different antitrust principles. There has been some debate about what the relevant market is and whether choosing one market over another really makes a substantive difference in this case. I would note, for example, that EchoStar has taken the position in litigation against DirecTV that DBS is the relevant market and that DirecTV is a monopoly in that market, but has more recently adopted a different and broader market definition. Also, one argument offered in support of the merger is that better competition to cable in the more urban areas, as well as more local television and pay-per-view offerings by the merged company, justify elimination of satellite television and broadband competition nationwide. Moreover, Mr. Kimmelman admitted that your analyses of the antitrust issues were correct, but that a broader view of some sort was required in this case, while attempting to argue that while DBS and cable were separate markets now, they would somehow become one market if the merger were approved. Could you comment in detail on these issues, including the relevant market definition and the nature of competition between cable and DBS, and, finally, give us your views of whether the antitrust laws allow benefits in one geographical or product market to be traded off against harm in another such market?

Answer: Let's examine the relevant market question from two points of view. As to the relevant geographic market, it is clear that the market is local. As a result of the merger, many subscribers and potential subscribers in rural America who do not have access to cable will see their choices reduced from two to one—two satellite companies merged to one. That surely is an ominous development for consumers.

As to relevant product market, I have not done the extensive study necessary to reach a firm conclusion. I tend to agree with the position advanced by EchoStar in the brief it filed about a year and a half ago that the two DBS companies compete most directly and substantially with each other and their prices respond to each other rather than to cable. That would make DBS a separate market or a sub-market and again the merger would result in monopoly. Another possibility is that DBS to some extent competes with cable so that the three are in the same relevant product market. Even in that situation, the merger reduces the relevant players from three to two, a level of concentration that has invariably been rejected in the courts.

Finally, you raised the question of whether anticompetitive effects in one section of the country can be justified by purported improvements in competition in another section. The answer is absolutely not. The relevant statute—Section 7 of the Clayton Act—is clear on the point. It says that a merger that lessens competition in “any section of the country” is illegal, and the courts have followed that plain meaning of the statute ever since it was amended in 1950.

Question 3: It was reported in the Wall Street Journal on February 6 [that—right up to the time at which the merger agreement was signed—EchoStar and DirecTV had been exploring ways to achieve these same spectrum efficiencies through a joint venture, but that effort failed due to control and economic factors. I would be interested in Mr. Ergen's and Mr. Hartenstein's elaboration on why such a joint venture is not a feasible alternative to this merger, and in Mr. Pitofsky's and [Attorney] General Nixon's analysis of that alternative. Could you both please provide a detailed explanation of the reasons that a joint venture is not a feasible alternative?

Answer: I am not familiar with the details of possible arrangements to serve consumers of satellite services through a joint venture. Often, a joint venture is a less restrictive alternative to a merger and can be equally efficient; I don't know if that is a possibility here.

Question 4: Attorney General Nixon and Mr. Pitofsky, I have heard that sensitive competitive information, such as specific programming contract terms, may have been disclosed by DirecTV to EchoStar in a manner that is not traditionally part of the normal due diligence process of a merger. I have also heard that some DirecTV customers have been contacted about needing to switch to EchoStar now, in advance of merger approval, to keep uninterrupted television service, reportedly by postcard, phone, and advertisement. Mr. Nixon and Mr. Pitofsky, would either of these activities, if true, raise concerns in the minds of antitrust enforcers as they review this merger?

Answer: It is important that parties, in the period leading up to merger approval, not “jump the gun” and exchange competitively sensitive information not reasonably necessary to negotiations. They should, of course, continue to compete until the proposed merger is approved. I have no independent information as to whether inappropriate actions occurred between EchoStar and DirecTV in negotiations leading up to the announcement of their proposed merger.

SUBMISSIONS FOR THE RECORD

Statement of Kirk Kirkpatrick, President and Chief Executive Officer, MDS America, Incorporated, Stuart, Florida

Mr. Chairman, Senator DeWine, and members of the Subcommittee:

Thank you for giving me this opportunity to submit written testimony as part of the official record of this important hearing examining the proposed merger between EchoStar and DirecTV.

My name is Kirk Kirkpatrick and I am the president and chief executive officer of MDS America, Incorporated (“MDS America”), a company headquartered in Stuart, Florida. MDS America is the North American licensee of MDS International, a company based in Lyon, France, that is the leading designer and manufacturer of terrestrial broadband transmission equipment in the 12.2 to 12.7 GHz band (the “DBS band”). MDS terrestrial systems utilize a wireless technology capable of transmitting video and high-speed Internet data in the DBS band, without causing harmful interference to satellite services operating at the same frequencies.

MDS International has been developing wireless terrestrial broadcast systems since 1986 and sold its first commercial system to the U.S. Government in 1997 to provide AFRTS for American military personnel in Oman. In the intervening time, it has deployed many of these systems worldwide in locations such as France, Kazakhstan, Cameroon, Gabon, New Zealand, and Greenland. Some of these systems share frequencies with DBS services in their areas. Most recently, the PTT of the United Arab Emirates awarded MDS International a pilot system toward a multi-million dollar contract to deploy a 300-hundred channel terrestrial system that will broadcast video programming throughout the seven emirates of the U.A.E.

Having achieved a track record of success overseas, MDS International, through its North American licensee MDS America, would now like to participate in the emerging U.S. market for fixed terrestrial wireless services. The prospect that DBS terrestrial spectrum-sharing will become a reality here in the United States is an exciting development: Spectrum sharing should increase competition in the multi-