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Before the

Committee on the Judiciary

United States House of Representatives

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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.[1] 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

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[1] Complaint at ¶¶ 84, 103, *United States v. Primestar, Inc. et al.*, (D.D.C. filed May 12, 1998).

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.[2] 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

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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 Bets on a Big Deal*, N.Y. TIMES, Oct. 30, 2001, at C1.

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.[3] Fortunately, the antitrust laws prevent mergers that lessen competition "in any section of the country,"[4] 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. One problem with that argument is that in almost all sections of the country, 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 competitors – a point that EchoStar ~~challenged a little more than a~~ year ago in a private antitrust lawsuit[5] – the merger would

3 *EchoStar Power*, WALL ST. J., Oct. 30, 2001, at A22.

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 also 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).

5 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,

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 Beechnut 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 often is suggested by those sponsoring a merger. In one of the first cases reviewed by the

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

[6] *Federal Trade Commission v. H.J. Heinz Co.*, 246 F.3d 708, 717 (D.C. Cir. 2001).

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

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7 *United States* v. *Philadelphia National Bank*, 374 U.S. 321, 370 (1963).

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 efficiencies, are not great. *Efficiencies almost never justify a merger to monopoly or near-monopoly.*" (Italics added.)[8]

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 those 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 proposed by EchoStar and DirecTV.

Finally, advocates of the proposed merger have advanced a most 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 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.

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[8] U.S. Department of Justice and Federal Trade Commission, REVISIONS TO HORIZONTAL MERGER GUIDELINES § 4 (1997), reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,104 (1997).

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 monopoly 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 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 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 market – 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 merger[9] and the AT&T/Media One merger[10], the Antitrust Division, the FTC and the FCC have all sought to preserve competition in this extremely important new market. Congress 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 handful 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 development. 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 consumers 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 broadband services. But the "duplication" they seek to eliminate is competition itself.

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9 *See American Online, Inc., and Time Warner, Inc.:* Analysis to Aid Public Comment, 65 Fed. Reg. 79861 (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, Inc., Transferors, to AOL Time Warner Inc., Transferee*, 23 Comm. Reg. 157 (FCC Jan. 22, 2001).

10 Proposed Final Judgment and Competitive Impact Statement: *United States v. AT&T Corp. and MediaOne Group, Inc.*, 65 Fed. Reg. 38584 (DOJ June 21, 2000); *In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from MediaOne Group, Inc., Transferor to AT&T Corp. Transferee*, 15 F.C.C.R. 9816 (FCC June 6, 2000).

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.

[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.