Testimony of

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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. 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%. 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%. 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. 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.

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." 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 "counterveiling 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."

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. 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. 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.

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."

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 each, on its own, achieve the same service. Other parties submitting petitions to the FCC have reached the same conclusion. 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. 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."

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.

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, 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 development. 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.