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EchoStar-DirecTV in the 2011 Technological and Competitive Climate

Peter J White, American University Washington College of Law

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PETER J. WHITE
# Table of Contents

Introduction ........................................................................................................................................... 1  

I. The FCC’s Merger Review Authority ................................................................................................. 2  
   A. Communications Act of 1934 ........................................................................................................... 2  
   B. Clayton Antitrust Act of 1914 .......................................................................................................... 3  

II. The FCC’s Standard of Merger Review ......................................................................................... 3  

III. Recent Satellite Merger Reviews .................................................................................................. 5  
   A. EchoStar–DirecTV (Abandoned Merger–2002) ............................................................................ 5  
   B. XM–Sirius (Successful Merger–2008) ............................................................................................ 8  

IV. Conclusions .................................................................................................................................... 9  
   A. Commitment Packages ..................................................................................................................... 9  
   B. Technological Advancements ......................................................................................................... 10  
   C. Revised 2010 *Horizontal Merger Guidelines* ............................................................................ 11  

V. Appendices ..................................................................................................................................... 1  
   A. National MVPD Subscriber Shares (June 2001) .......................................................................... 1  
   B. Monthly Prices for DirecTV’s and EchoStar’s Most Popular Programming Packages ................... 1  
   C. Monthly Per-Channel Prices for DirecTV’s and EchoStar’s Most Popular Programming Packages ................................................................................................................................. 2  
   D. Percent of Domestic Transponders Activated by SES Americom, DirecTV, and EchoStar in Domestic Wholesale Relevant Markets .................................................................................................................. 2
INTRODUCTION

The birth of satellite television took place in the late 1970s, and since then, the Direct Broadcast Satellite (DBS) industry has grown to over 30 million subscribers. In 2008, DirecTV and EchoStar—the leaders in the DBS market—had 20.1 million and 13.8 million subscribers respectively. DBS networks work by broadcasting digital signals from medium- and high-power satellites (100 to 400 watts per transponder) to receiver dish antennas as small as 18 inches. These satellites are placed in geosynchronous orbits, which means that they are always in the same position relative to the rotating earth. In the United States, the Federal Communications Commission (FCC or Commission) regulates these broadcast satellites under the authority given to it by the Communications Act of 1934. The FCC also has the authority to grant or deny mergers of regulated enterprises, including satellite radio and DBS companies.

In 2001, DirecTV and Echostar submitted merger applications to the Department of Justice (DOJ) Antitrust Division and the FCC. Although the FCC denied this merger, the Commission granted a merger of similarly market-dominant companies in its approval of the XM–Sirius merger in 2008.

Part I of this Article addresses the FCC’s merger review authority. Part II defines the FCC’s standard of merger review. Part III of this Paper will briefly discuss the approved XM–

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2 Eli M. Noam, MEDIA OWNERSHIP AND CONCENTRATION IN AMERICA 178 (2009).
3 Id.
7 Jim Chen, Telecommunications Mergers, in COMPETITION POLICY AND MERGER ANALYSIS IN Deregulated and Newly Competitive Industries 52, 53 (Peter C. Carstensen & Susan Beth Farmer, eds., 2008).
Sirius merger as well as the rejected EchoStar–DirecTV merger. Finally, Part IV discusses why the EchoStar–DirecTV merger might be approved if it were to be brought before the Commission today with a focus on voluntary commitment packages, technological advancements, and the revised 2010 *Horizontal Merger Guidelines*.

I. THE FCC’S MERGER REVIEW AUTHORITY

The FCC has regulated the services of communications satellites since the beginning of the space age. Although communications satellites were not mentioned in the 1934 Communications Act, the FCC regulates satellites by virtue of its authority over radio transmissions and common carriers in the communications business. The FCC’s ability to review mergers is grounded in two statutes: the Communications Act of 1934 and the Clayton Antitrust Act of 1914.

A. COMMUNICATIONS ACT OF 1934

The Communications Act of 1934 mandates that the FCC must approve any merger involving a regulated enterprise. Originally, it gave the FCC authority to grant antitrust immunity to certain telecommunications mergers, but this authority was repealed in the 1996 amendments to the Act. Specifically, the 1996 Act states that “nothing in this Act or the amendments made by this Act shall be construed to modify, impair, or supersede the applicability of any of the antitrust laws.” In *Verizon Commc’n, Inc., v. Law Offices of Curtis

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8 BLUMENTHAL & GOODENOUGH, supra note 4, at 58. The first use of communications satellites dates back to the 1960s. Id.
9 Id.
14 Id. § 601(b)(1).
V. Trinko, LLP, the Supreme Court held that § 601 “bars a finding of implied immunity [from] claims that satisfy established antitrust standards.” Therefore, FCC approval is required for a telecommunications merger, but it is never enough on its own; the merger will be subject to antitrust scrutiny from other antitrust authorities.

B. CLAYTON ANTITRUST ACT OF 1914

The antitrust review of mergers is generally governed by § 7 of the Clayton Antitrust Act. Section 7, which includes no criminal penalties, prohibits any merger in which the effect of the transaction may be to “substantially lessen competition [or] tend to create a monopoly . . . in any line of commerce or in any activity affecting commerce in any section of the country.” The Clayton Act also grants authority to the FCC to review and reject mergers involving at least one “common carrier engaged in wire or radio communication or radio transmission of energy.”

II. THE FCC’S STANDARD OF MERGER REVIEW

Generally, the FCC reviews mergers under the “public interest, convenience, and necessity” standard found throughout the Communications Act of 1934 instead of invoking the Clayton Act. The “public interest” standard is “so construed as to secure for the public the broad aims of [the statute]." The FCC has the “responsibility to determine when and to what extent the public interest would be served by competition” because the public interest standard

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16 Id. at 406–07.
17 Chen, supra note 7, at 54.
19 Id. § 21(a).
20 Chen, supra note 7, at 54.
“necessarily subsumes and extends beyond the traditional parameters [of] . . . the antitrust laws.”

The primary area of concern when determining the competitive implications of a merger arises when the merger eliminates competition between parties and results in a substantial increase in concentration within a relevant product market and geographic market. These markets are defined from a consumer’s viewpoint. In determining the product market, the FCC seeks to determine to what extent products and firms are substitutes for each other (i.e., if the price of one product increases, what is the likelihood that consumers will switch to another product serving the same function?). In determining the geographic market, the FCC examines the choices realistically available to consumers in particular locations.

After the product and geographic markets have been defined, the FCC performs a structural review of the market, determines the market share of each of the parties, the level of concentration in the market, and trends in the level of concentration. The FCC relies heavily on the Herfindahl–Hirschman Index (HHI), which is a measure of concentration that is calculated based on the distribution of the size of firms in a given market. There is a presumption of illegality if post-merger HHIs are above certain thresholds. Also, the

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23 Schurz Commc’n, Inc. v. FCC, 982 F.2d 1043, 1049 (7th Cir. 1992).
24 Chen, supra note 7, at 54.
25 ABA SECTION OF ANTITRUST LAW, TELECOM ANTITRUST HANDBOOK 59 (2005) [hereinafter TELECOM ANTITRUST HANDBOOK].
26 Id.
27 Id. at 60.
28 Id. at 60.
29 Annual Report and Analysis of Competitive Market Conditions with Respect to Domestic and International Satellite Communications Services, FCC 07-34, IB Docket No. 06-67, (Mar. 26, 2007), ¶ 69 [hereinafter First Satellite Competition Report]. The HHI is equal to the sum of the squares of the market share of each market participant and can range from nearly zero in atomistic markets to 10,000 in monopolies. Id. ¶ 70.
30 TELECOM ANTITRUST HANDBOOK, supra note 25, at 61 (citing FTC v. H.J. Heinz Co, 246 F.3d 708, 715 (D.C. Cir. 2001)).
Commission considers efficiencies claimed by the merging parties, and it balances those efficiencies against the possibility of anticompetitive effects.\footnote{Id.}

The merger analysis followed by the FCC is very similar to that followed by the DOJ and FTC, and those guidelines are set forth in the DOJ’s and FTC’s Horizontal Merger Guidelines,\footnote{U.S. Dep’t of Justice & Fed. Trade Comm’n, Horizontal Merger Guidelines (2010), available at http://www.ftc.gov/os/2010/08/100819hmg.pdf.} discussed below in Part IV.C. However, the public interest standard does not bind the FCC “to analyze proposed mergers under the same standards that the [DOJ] . . . must apply” under § 7 of the Clayton Act.\footnote{Chen, supra note 7, at 55 (citing Ne. Util. Serv. Co. v. FERC, 993 F.2d 937, 947–48 (1st Cir. 1998)).} In fact, the public interest standard is broader than the antitrust standard underlying § 7 of the Clayton Act.\footnote{Id. at 56.} The Supreme Court has held that if the FCC were to confine its analysis to only the antitrust laws, the Commission might fail to fulfill its statutory obligation to uphold the public interest.\footnote{Id. (citing United States v. Radio Corp. of Am. & Nat’l Broad. Co., Inc., 358 U.S. 334, 351–52 (1959)).} The next Part includes a brief analysis of the XM–Sirius and the rejected EchoStar–DirecTV merger in light of the standards set forth above.

### III. Recent Satellite Merger Reviews

This Part provides an overview of the abandoned EchoStar–DirecTV merger (2002) and the successful XM–Sirius merger (2008).

#### A. EchoStar–DirecTV (Abandoned Merger–2002)

One year after EchoStar and DirecTV announced their intent to merge,\footnote{EchoStar Communications Corp., General Motors Corp. & Hughes Electronics Corp, Consolidated Application for Authority to Transfer Control, FCC CS Docket No. 01-348 (Dec. 3, 2001), available at http://www.fcc.gov/transaction/echostar-directv/echostarappli.pdf.} the DOJ filed a lawsuit to block the merger and was joined by twenty-three states, the District of Columbia, and
Puerto Rico.\textsuperscript{37} The DOJ maintained that the merger would eliminate competition between the United States’ two leading DBS services and reduce competition in the multichannel video programming distributor (MVPD)\textsuperscript{38} market.\textsuperscript{39} The FCC also objected to the merger, and in response to the DOJ’s and FCC’s challenges, EchoStar and DirecTV abandoned their proposed merger.\textsuperscript{40}

Those in favor of the merger argued that the merger would have allowed the providers to use the DBS spectrum more efficiently by eliminating duplicative channels, as there was a large overlap in the programming offered by EchoStar and DirecTV.\textsuperscript{41} Because both companies faced significant capacity constraints, streamlining spectrum use was an important efficiency that weighed heavily against possible anticompetitive effects.\textsuperscript{42}

The FCC defined the product market as including all MVPD services but noted that MVPD services are highly differentiated; EchoStar and DirecTV are closer substitutes for each other than for cable systems or other MVPDS.\textsuperscript{43} Further, they noted that most consumers do not consider over-the-air television to be a suitable substitute for cable or DBS services, since over-the-air broadcast does not include the variety of programming characteristic of DBS and cable.\textsuperscript{44} There was also a significant price cap between the price of analog and digital cable services, indicating product differentiation.\textsuperscript{45}

\textsuperscript{37} Gilbert & Ratliff, \textit{supra} note 1, at 117.
\textsuperscript{38} The FCC defines MVPD suppliers as entities that offer multiple channels of video programming for purchase by subscribers or customers. 47 C.F.R. § 76.1000(e).
\textsuperscript{39} Gilbert & Ratliff, \textit{supra} note 1, at 117.
\textsuperscript{40} Id.
\textsuperscript{42} Gilbert & Ratliff, \textit{supra} note 1, at 117.
\textsuperscript{43} \textit{Id.} at 119.
\textsuperscript{44} \textit{Id.} For a breakdown of the national MVPD subscriber shares in June 2001, see Appendix A.
\textsuperscript{45} \textit{Id.} at 120.
Initially, the parties argued that the relevant geographic market was the national market because both parties had national pricing plans. However, because both parties have targeted promotions at local levels, the ability to price at the local level, and varying cable prices and service offerings at the local level, the geographic market was determined to be the cable franchise area for regions with cable service and the Designated Market Area (DMA) for regions without cable service. Almost all of the MVPD markets were highly concentrated, and the HHIs exceeded the thresholds set forth in the 1997 *Horizontal Merger Guidelines* for mergers that raise significant competitive concerns.

The DOJ noted that competition between EchoStar and DirecTV was intense, not only in price, but the number and diversity of channels, as well. Further, it was cheaper to subscribe to EchoStar or DirecTV than cable—evidence that there was direct competition between EchoStar and DirecTV. Entry into the market is also difficult, since the only three FCC-regulated orbital satellite slots capable of servicing the entire continental United States were occupied by EchoStar and DirecTV.

In terms of efficiencies, proponents of the merger highlighted the streamlining effect the merger would have on scarce radio spectrum. The two parties had between 290 and 325

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46 Id.
47 Id. A DMA is defined by Nielsen Media Research as a group of counties that makes up a particular television market. Id.
48 The *Horizontal Merger Guidelines* were updated in 2010. The 1997 version, referred to in this merger, is available at http://www.ftc.gov/bc/docs/horizmer.shtm.
49 Id. at 121.
50 For a chart depicting the monthly prices for DirecTV’s and EchoStar’s most popular programming packages, see Appendix B.
51 For a chart depicting the monthly per-channel prices for DirecTV’s and EchoStar’s most popular programming packages, see Appendix C.
52 Id. at 121–23.
53 Id.
54 Id. at 132–33. These slots are located at 101º, 110º, and 119º W.L.
55 Id. at 134.
redundant channels, which had the effect of causing a spectrum shortage for both companies.\textsuperscript{56} Had the companies been allowed to merge, they would no longer need redundant satellite connections and could free up scarce radio spectrum to benefit consumers.\textsuperscript{57}

**B. XM–SIRIUS (SUCCESSFUL MERGER–2008)**

Sirius and XM announced their plan to merge in 2007.\textsuperscript{58} The FCC granted their merger over 500 days later,\textsuperscript{59} and the DOJ, in 2008, concluded that the merger posed no threats to competition.\textsuperscript{60} An FCC Commissioner disagreed with the DOJ’s decision, in part because the DOJ found that there was a lack of competition between the two companies because there was no radio that could receive a signal from both Sirius and XM; that is, consumers could not easily switch from one carrier to the other.\textsuperscript{61} The XM–Sirius merger approval required the parties to agree to certain conditions: a three-year price cap on subscription rates; a la carte channel options; set-asides for noncommercial educational or informational programming and diversity programming for qualified entities; and designing and marketing an interoperable radio.\textsuperscript{62} At the time of the merger, XM and Sirius were the largest providers of satellite radio service in the United States.\textsuperscript{63}

\textsuperscript{56} Id.
\textsuperscript{57} Id.
\textsuperscript{59} Id.
\textsuperscript{61} Leigh M. Murray, *Sirius Mistake: The FCC’s Failure to Stop a Merger to Monopoly in Satellite Radio*, 59 Am. U. L. Rev. 83 (2009) (noting that an FCC Satellite Radio Order “required the licensees to develop and market an interoperable radio to ensure robust competition between the two companies,” but that they failed to do so for eleven years).
\textsuperscript{62} Id. at 94 (citing XM–Sirius Merger Order, supra note 58, at 12359).
\textsuperscript{63} Carroll, *supra* note 41, at 664.
IV. CONCLUSIONS

Although the XM–Sirius and EchoStar–DirecTV mergers are vastly different creatures, they are similar in several ways. Both mergers involved two companies with the highest market shares in their product markets—digital satellite radio and DBS, respectively. Both arguably had the possibility of creating monopolies in these product markets. Both were subject to the FCC’s “public interest” test for merger review as well as general antitrust scrutiny. This Part concludes that, in light of the XM–Sirius merger and the changing competitive and technological landscapes in the telecommunications market, the EchoStar–DirecTV merger might be approved if it were to be brought before the Commission today.

A. COMMITMENT PACKAGES

A commitment package formed the foundation of the XM–Sirius merger. It not only gave the FCC temporary power over some critical business choices of the companies (e.g., the three-year subscription price cap), but it also helped tilt the “competitive harm–competitive benefit” balance in favor of competitive benefit. Had EchoStar or DirecTV known that a voluntary commitment package could help to significantly tilt this balance, the parties might not have been so quick to abandon the deal when faced with opposition from the DOJ and the FCC. One scholar proposes that EchoStar–DirecTV voluntarily commit to 1) lease a certain amount of satellite capacity to qualified programmers in order to maintain program diversity, and 2) cap monthly charges in rural areas to the lowest fees paid by subscribers anywhere in the United States.64

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64 Id. at 672 (citing Andy Pasztor & Vishesh Kumar, Dish Network Again Casts Its Deal Gaze at DirecTV, WALL ST. J., Aug. 5, 2008, at B1).
B. TECHNOLOGICAL ADVANCEMENTS

Advancements in technology since 2002 serve to broaden the MVPD market and increase competition by offering an almost ubiquitous method of distributing video to consumers. The past two years have seen a drastic rise in popularity of sites such as Hulu, which streams TV shows from NBC, Fox, ABC, and numerous other networks and studios, and NetFlix, which offers on-demand video streaming over the internet and flat-rate online video rental of DVD and Blu-ray Discs. If a merger were to be analyzed today, media outlets such as these might be included in the product market with DBS, since more and more Americans are watching television shows online. This broadening of the product market would serve to lower the market shares of the merger participants, evince a less concentrated market, and drive the HHI downward, favoring merger approval.

However, technological advancements could work against the merger by attacking the primary efficiency proffered by the merging parties: efficient spectrum use. Recent advancements in video compression technology have quenched EchoStar’s and DirecTV’s spectrum shortage caused by duplicative video programming. Although the parties abandoned the merger following objections from the FCC and DOJ, they were able to increase programming by using signal compression and launching additional satellites. EchoStar deployed four new satellites since 2002, and DirecTV deployed five, costing a total of $2–3 billion.

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65 Id. at 669 (stating that the percentage of Americans that get their news from online sources increased by fifty percent from 2002 to 2004, and nearly 80 million Americans watch their favorite television shows online, according to a 2007 study).
66 “[A]n HHI in markets in which there are few, large purchasers is of limited value due to the countervailing power between supplier and purchaser.” First Satellite Competition Report, supra note 29, ¶ 172. For a chart showing the percent of domestic transponders activated by SES Americom, DirecTV, and EchoStar in 2001, 2006, and 2007, see Appendix D.
67 Id. at 135.
68 Id.
C. **REVISED 2010 HORIZONTAL MERGER GUIDELINES**

The *Horizontal Merger Guidelines*, first adopted in 1968 and revised in 1992 and 2010, serves as an “outline of the main analytical techniques, practices and enforcement policies the FTC and the Department of Justice use to evaluate mergers and acquisitions involving actual or potential competitors under federal antitrust laws.” The 1992 version that is referenced in both the XM–Sirius and EchoStar–DirecTV mergers differs in many respects to the 2010 version. The 2010 version is more likely to allow for a less structured, open-ended, case-by-case evaluation of the merger, as opposed to the more rigid structure of the 1992 version.

For example, the 2010 version clarifies that merger analysis “does not use a single methodology, but is a fact-specific process through which the agencies use a variety of tools to analyze the evidence to determine whether a merger may substantially lessen competition.” Further, they “[e]xplain that market definition is not an end itself or a necessary starting point of merger analysis, and market concentration is a tool that is useful to the extent it illuminates the merger’s likely competitive effects.”

Although the FCC is not bound by the *Horizontal Merger Guidelines*, telecom mergers are still susceptible to standard antitrust scrutiny, and therefore these guidelines are relevant. The 2010 version, with its new focus on fact-specific processes as opposed to rigid methodologies, provides antitrust authorities with the freedom to analyze mergers in a less constrained way. Although this paradigm shift could work both against and in favor of the merger, there has certainly been a change in the federal merger review environment that may change the regulatory outcome if the merger were announced today.

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70 Id.

71 Id.
V. APPENDICES

A. NATIONAL MVPD SUBSCRIBER SHARES (JUNE 2001)\textsuperscript{72}

<table>
<thead>
<tr>
<th>Service</th>
<th>Percent of MVPD Subscribers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cable</td>
<td>78.0</td>
</tr>
<tr>
<td>DBS (Direct Broadcast Satellite)</td>
<td>18.3</td>
</tr>
<tr>
<td>SMATV (Satellite Master Antenna Television)</td>
<td>1.7</td>
</tr>
<tr>
<td>C-band</td>
<td>1.1</td>
</tr>
<tr>
<td>MMDS (Multichannel Multipoint Distribution Service)</td>
<td>0.8</td>
</tr>
</tbody>
</table>

B. MONTHLY PRICES FOR DIRECTV’S AND ECHOSTAR’S MOST POPULAR PROGRAMMING PACKAGES\textsuperscript{73}

\textsuperscript{72} Gilbert & Ratliff, supra note 1, at 119.

\textsuperscript{73} Id. at 122.
C. Monthly Per-Channel Prices for DIRECTV’s and ECHOSTAR’s Most Popular Programming Packages

![Graph showing price per channel over time for DirecTV and Echostar packages]

D. Percent of Domestic Transponders Activated by SES Americom, DIRECTV, and ECHOSTAR in Domestic Wholesale Relevant Markets

<table>
<thead>
<tr>
<th></th>
<th>2001</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>SES Americom</td>
<td>0</td>
<td>14</td>
<td>8</td>
</tr>
<tr>
<td>DirecTV</td>
<td>67</td>
<td>52.5</td>
<td>59</td>
</tr>
<tr>
<td>Echostar</td>
<td>33</td>
<td>33.5</td>
<td>33</td>
</tr>
</tbody>
</table>

74 Id. at 123.