BARRON'S

Antitrust in Orbit

Theory and practice collide in the great satellite TV merger

April 15, 2002

By Thomas Hazlett

There are two satellite TV providers in the United States, and the smaller one, EchoStar, wants to pay $26 billion to buy the larger one, DirecTV. The result could dramatically realign broadband markets. But first, the Antitrust Division of the U.S. Department of Justice must decide if the proposed combination will lessen competition, and the Federal Communications Commission will weigh whether it is in the "public interest."

As with most merger approvals, everything tips on how one defines the relevant market. But the twist here is that both parties, EchoStar and the government, are haunted by their past pronouncements.

If EchoStar were forced to adhere to the position it advanced in its February 2000 antitrust suit against DirecTV, the merger would result in 100% market share in direct-broadcast satellite service-instant monopoly, just add water.

But if the Justice Department consults its own May 1998 analysis in an antitrust complaint against Primestar (which was then the third satellite provider), "The relevant product market…[is] multichannel video programming distribution." Defined this way, cable systems have 80% share of the relevant market, and the creation of a more powerful satellite TV rival would be a competitive booster shot. The Justice Department would be hard pressed to stand in the way of such a boon to consumers.

The word on the street is that the DBS merger is doomed by the law of small numbers. When all the massive legal briefs have been filed, antitrust watchers believe in the "3/2" rule-three firms look competitive, two like monopoly.

A Feast of Lawyers

While the EchoStar bid for DirecTV has stirred a hornet's nest of opposition from broadcasters, cable TV companies, and state attorneys general, the combination is being supported by well-connected heavy hitters. David Boies, of U.S. v. Microsoft fame, teams with Robert Russell, a respected ex-antitrust official at Justice, to lead the legal fight for the merger. In another twist, the lawyers have enlisted three merger-bashing advocacy groups -- Consumer's Union, Consumer Federation of America, and the Media Access Project -- to form a pro-merger coalition.

Not that it matters, the combination might just be a very good deal for consumers. In your average, off-the-shelf telecom mega-merger, firms seek regulatory approval by summing up gains from "synergy." In this vein, EchoStar claims up to $3.2 billion annual savings on overhead of various kinds. These savings rise with each additional customer and increase the likelihood that the post-merger DBS operator will lower prices. But synergies alone are not enough to ensure that consumers will benefit from the merger.

Across the U.S. there are essentially three choices for video subscription service -- DirecTV, EchoStar, and the local cable operator. The merger makes three competitors go to two -- you know the rest. Moreover, merger opponents dwell on the 3% of U.S. household no TV cable passes -- in fact, they argue that the number is not 3% (where the FCC puts it), but much higher. In these areas, two goes to one. That looks bad.

At least it looks bad until one examines "United States v. Primestar," where the Justice Department's economic analysis clearly provides a precedent to greenlight this merger. In that proceeding, antitrust regulators moved to block Primestar -- owned by cable TV companies -- from buying satellite slots owned by Rupert Murdoch's News Corp. They feared that Primestar was only a lackluster rival, stockpiling DBS licenses while offering packages that could only appeal to folks without access to cable. When the Primestar-News Corp. combination was opposed by regulators, Primestar sold its 2.2 million subscribers to DirecTV in January 1999; News Corp. then unloaded its DBS slots to EchoStar. The Justice Department quickly embraced both deals. While chopping DBS players from three to two, Justice felt the DBS survivors, buff with new customers and spectrum capacity, could more effectively bargain with cable-program networks and more strongly compete with cable-system operators.

If the bone-chilling predictions about a DBS monopoly in those places where cable systems don't string wire are true, today's market should validate that claim: Prices should be noticeably higher where DBS firms enjoy a cozy duopoly. But DirecTV and EchoStar charge uniform national prices. EchoStar has pledged to continue to do so after the merger, a claim attacked by merger opponents as unenforceable. Perhaps. But what is clearly unenforceable is a hypothetical satellite discrimination plan that gouges customers living in places not passed by cable. Satellite service is universal. Indeed, satellite sales cannot be successfully indexed to national boundaries, as Canadian authorities, annoyed by 1 million gray-market subscribers to U.S. services, might attest.

The Evidence

The big-time pay-off of the DBS merger is that it doubles capacity. EchoStar's 600 channels will (with some new set-top boxes) become 1,200. With the launch of additional "spot beam" satellites sub-dividing frequencies, capacity will increase again, and each platform will be twice as capacious. Throwing more video channels at customers would invigorate the alternative to cable TV, and fatter bandwidth for data would pump life into the rivalry with cable modems and DSL for high-speed Internet access.

Powerful testimony to the price-lowering effect of this DBS capacity expansion is provided by cable systems opposing the deal. A trade group, the American Cable Association (ACA), is crying that cable profits are already squeezed by EchoStar's offer of 100 channels for $9 per month ("At this rate, ACA members could not even cover their costs of programming"), the group claims that the merger would make their predicament far worse. That's evidence for the merger.

New Services

The first new thing that EchoStar offers is local TV. Today, satellite operators serve only about the top 40 local TV markets. These 40 markets eat up about 500 channels of capacity. Due to "must carry" rules that went into effect January 1, 2001, all local TV stations have to be delivered wherever any are offered. But there are another 170 TV markets featuring about 1,000 additional stations. Some more spot-beams will be needed, but only buying DirecTV makes a national roll-out of local TV signals economic. Indeed, EchoStar CEO Charles Ergen has pledged to broadcast local stations in all 210 markets if the merger is approved.

Ergen has a golden opportunity to put the big picture in high-definition clarity with a more ambitious strategy. First, EchoStar should commit to delivering free local TV signals to every U.S. household. EchoStar would become a national antenna service, beaming broadcast TV signals to any dish in the land. Second, EchoStar should endorse the licensing of Northpoint Technology, a firm vying since 1994 for the chance to deploy a new subscription-TV system by sharing spectrum in the satellite band. This entrepreneurial investment in innovative technology creates new bandwidth out of thin air, and should be rewarded by the FCC; instead, the Commission has blocked deployment for years and may now appropriate it by auctioning the right to implement Northpoint's idea. [Disclosure: The author wrote a policy analysis of the issue for the FCC at the behest of Northpoint last year and was paid a fee for it.] Restoring the subscription-TV competitor swallowed by merger makes the case for Northpoint a no-brainer. EchoStar, an ardent Northpoint foe, should break the logjam by doing the unthinkable-supporting the right of its competitor to compete.

Broadcasting all U.S. TV signals via satellites would take us one giant step closer to the Grand Spectrum Policy Prize: liberating the TV band. This 402 MHz of prime spectrum -- twice the entire allotment for wireless telephone service-is walled off for a transmission mode that no one needs and few are watching. Reallocating the TV airwaves to the phone and Internet wireless services that users really want would jump-start emerging networks and the broadband economy.

Of course, as an FCC economist said during a discussion of the economics of another merger some years back, "This thing is way too important to be decided on the merits."

About Thomas Hazlett: articles, bio, and photo