Policy Brief

Stanford Institute for Economic Policy Research

# Antitrust Implications of Echostar-DirecTV Proposed Merger

Gregory L. Rosston

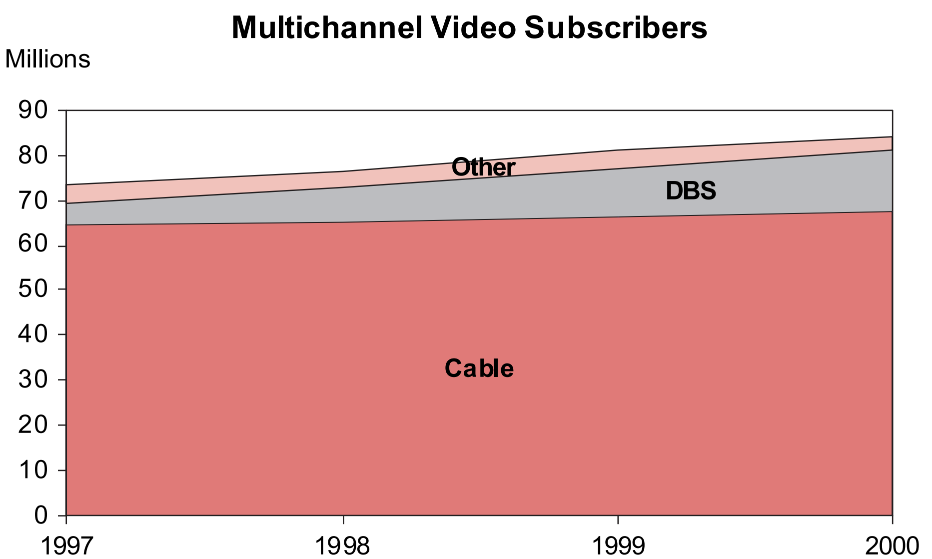
Echostar Communications, the owner of Dish Network, recently made headlines with its $26 billion bid to acquire DirecTV from General Motors/Hughes Electronics. There has been a lot of speculation about the merger because of antitrust concerns. The Department of Justice (DOJ) stopped the proposed MCI-Sprint merger that would have reduced the three major long distance companies to two (with a number of smaller competitors). Some people claim that the Echostar-DirecTV acquisition will reduce the number of Multi-Channel Video Distributors (MVPD) from three to two (cable being the other). This note will examine these antitrust concerns, provide an outline of the likely analysis that DOJ will undertake and assess some of the arguments the parties will put forth to justify why they feel their merger will enhance competition

## Competition in Relevant Antitrust Markets

The first step for antitrust regulators is to define the relevant antitrust markets in which the merging parties compete. In antitrust analysis, there are relevant product markets and relevant geographic markets. To determine the relevant markets, the first step is to examine the products sold by the merging parties.

DirectTV and Echostar both provide direct broadcast satellite (DBS) service to customers in the United States: DirecTV has about 10 million subscribers and Echostar's Dish Network serves another 6 million subscribers. With an 18-inch dish, these consumers can receive a wide variety of high-quality television signals. Both companies provide hundreds of channels of programming, each with a basic package and multiple premium and pay-per-view packages.

November 2001



Source: FCC Seventh Annual Cable Competition Report

It is likely that the relevant product market definition will be multi-channel video programming distribution (MVPD), since both firms provide a wide variety of video signals. Cable television systems also provide multiple channels of video and would be included in an MVPD relevant market. The DBS providers are likely to argue that they need to merge in order to compete with cable providers in the MVPD market. Figure 1 shows cable has about 68 million subscribers, or 80% of MVPD subscribers across the country. There are other MVPD providers (MMDS, cable over-builders, large C-band satellite operators), but they are relatively small, accounting for less than 5% of MVPD subscribers. DBS providers have been making inroads in the past few years – they attracted about 3 million new subscribers last year compared to slightly more than 1 million new cable subscribers. Two advantages for the satellite systems have been their capacity and picture quality. But cable systems have been upgrading their infrastructure to provide high-quality digital video and increased numbers of channels as well as high-speed data services, so the satellite advantages in these dimensions may be disappearing.

The relevant geographic market(s) will pose some interesting questions. Clearly, for an individual household, the relevant choice set includes the set of signals that reach the house. For a consumer in Palo Alto, a cable system in Mountain View does not provide a competition to the MVPD providers in Palo Alto. So the relevant geographic markets are likely to be quite localized. But, in areas where competition is similar, the analysis will turn out the same, so that it is possible to aggregate areas with similar competitive conditions. As a result, the relevant market distinctions probably will be twofold: areas where there are cable systems and areas where there are no cable systems. Cable systems currently cover about 97% of the homes in the country.

About 3% of homes in the country do not have the choice of cable service. Antitrust authorities will be concerned about the impact of the merger on these consumers. There may be some ways to protect rural subscribers without cable. DBS service is nationwide and is currently marketed on a nationwide basis with uniform pricing. If the DBS providers are unable to differentiate between households with cable access and those without cable access, competition for 97% of households surely would protect the remaining 3% of households. This will be a tough argument to support, as targeted marketing campaigns, competitive responses, etc. probably will be used to compete with specific cable companies that might offer special deals. However, even though the statutory language of the Sherman Act says to evaluate "any market," it may be tough to block a merger that hurts 3% of consumers if it benefits 97% of consumers. Thus, DOJ will examine cabled markets as well.

In cabled areas, the concern is that essentially the three major MVPD competitors go down to two. In some areas of the country, it will be a decrease from four to three or even five to four with multi-channel multi-point distribution services and cable overbuilders, but there are relatively few overbuilders and MMDS has not been a major competitor in the MVPD market to date. With a decrease from three competitors to two and existing high concentration, the merger is likely to be presumed to harm competition absent countervailing effects.

## Efficiencies Arguments

The major argument for the merger is likely to be claims of efficiencies that will reduce costs and increase quality. Through the merger, the parties will claim that they will be more effective competitors to cable because the merger will reduce costs. There are a couple of reasons that this might hold. The first is that onerous "must carry" rules require that a satellite provider that wants to carry any local signals into a market will have to carry all local signals in that market. There are more than 1,600 television stations across the country. Even to cover the top 100 markets (85% of the population) with local signals, the DBS providers would have to devote more than 800 channels alone to local signals (including replicating the network feeds into each market). The efficiency comes in because of the limited space on satellites – instead of each devoting 800 channels to local broadcasts, they could share the burden and increase the number of local markets served. The firms also would claim they would be able to eliminate duplication of other signals as well.

Usually, antitrust authorities and courts are skeptical of claimed efficiencies and look for ways to accomplish the cost savings short of a merger. The parties will have to show that it would be cost prohibitive to broadcast a sufficient number of local signals without the merger. They would have to show that Echostar could not use its own two full CONUS slots and spot beam technology with digital compression to be a viable stand-alone competitor to cable systems. They also would look at the ability to use other domestic and foreign satellite slots as well.

DBS providers also are likely to claim that the merger will better allow them to provide two-way services like high-speed Internet access. Like the local channel argument, this will be a fact-intensive investigation that will depend on how either firm could provide the service on its own or whether there are ways to achieve the efficiencies absent the merger. To make this argument, the parties would have to show that consumers have a high preference for a bundle of services or that a joint technology providing video and data from a single satellite or through a single dish provides substantial cost savings.

## Conclusion

This merger is likely to receive intense scrutiny by antitrust authorities. Both firms have been very successful at signing up new customers over the past few years, but given capacity constraints and the local carriage requirements, they do have a constraint that may be more binding than their cable competitors. They will need to show DOJ that the combination will lead to substantial efficiencies that are not available in other ways, and even if they can show that, they will need to show that the reduction in the number of firms will not harm consumers.

The obvious antitrust concerns bring up an interesting business issue: Why did GM accept the $26 billion offer from Echostar rather than a $24 billion offer from Rupert Murdoch and News Corp.? GM itself will end up owning 11% of the new Echostar Communications. But there is a risk that DOJ will prevent the deal. In this case, there is a breakup fee as part of the deal and then GM can go back to News Corp., but there is no guarantee that News Corp. still will be willing to offer $24 billion without competition from Echostar. So either GM feels that the risk of outright denial of the deal is sufficiently low, that there is some other buyer that will force the bidding up or that DirecTV is still valuable on its own. The second two explanations tend to weaken the efficiencies arguments that will be used to justify the merger because it shows the value of DirecTV as a stand-alone entity.

## About the author

Gregory L. Rosston is the Deputy Director of SIEPR. He is also a Lecturer in Economics at Stanford University. Dr. Rosston's research has focused on industrial organization, antitrust and regulation. He has written numerous articles on competition in local telecommunications, implementation of the Telecommunications Act of 1996, auctions and spectrum policy.

Prior to joining Stanford University, Rosston served as Deputy Chief Economist of the Federal Communications Commission and helped with the design and implementation of the FCC's spectrum auctions. He is a graduate of UC Berkeley and received his Ph.D. in Economics from Stanford University.

*The Stanford Institute for Economic Policy Research (SIEPR) conducts research on important economic policy issues facing the United States and other countries. SIEPR's goal is to inform policy makers and to influence their decisions with long-term policy solutions.*

*With this goal in mind SIEPR policy briefs are meant to inform and summarize important research by SIEPR faculty. Selecting a different economic topic each month, SIEPR will bring you up-to-date information and analysis on the issues involved.*

*SIEPR Policy Briefs reflect the views of the author. SIEPR is a non-partisan institute and does not take a stand on any issue.*

*For additional copies, please see SIEPR website at: http://SIEPR.stanford.edu*

SIEPR **Policy Brief**

A publication of the
Stanford Institute for Economic Policy Research
Stanford University
579 Serra Mall at Galvez Street
Stanford, CA 94305
MC 6015