

**Testimony of Bob Phillips, President and CEO of the
National Rural Telecommunications Cooperative
Before the U.S. House of Representatives Committee on the Judiciary
Regarding Direct Broadcast Satellite Service and Competition in the
Multichannel Video Distribution Market**

Monday, December 4, 2001

Introduction

Good morning. Mr. Chairman, Ranking Representative Conyers and other Members of the Committee, it is a privilege to appear before you to discuss direct broadcast satellite service and competition in the multichannel video distribution market. I will focus upon the impact on rural Americans of the proposed merger between EchoStar and Hughes Electronics/DirecTV.

My name is Bob Phillips, and I am the President and CEO of the National Rural Telecommunications Cooperative (NRTC). From our founding in 1986, NRTC's primary mission has been to bring the same state-of-the-art telecommunications services often found in urban areas to those who live and work in rural America.

NRTC Background

As a national cooperative, NRTC provides our members and affiliates with comprehensive technology solutions that include product research and development, technical support, marketing assistance, industry representation, and product and service distribution.

NRTC was founded in 1986 to bring valuable telecommunications services to rural communities, just as our rural electric and telephone members helped bring electricity and telephone service to rural America in the 1930s, 40s and 50s.

NRTC first entered the satellite business by offering C-band (large dish) television service to rural communities. In the early 1990s, we forged an important partnership with

DirecTV, Inc., a unit of Hughes Electronics Corporation. NRTC and its members invested more than \$100 million toward launching DirecTV -- the nation's first and most successful high-power direct broadcast satellite (DBS) system. This money and NRTC's participation was absolutely critical to the launch of DirecTV's business. In return for this necessary seed capital, NRTC's participating members and affiliates became the local distribution channel for this valuable service in certain portions of rural America. Today, NRTC, through its participating members and affiliates, including Pegasus, serves more than 1.8 million rural consumers with DirecTV service, representing nearly 20 percent of DirecTV's entire subscriber base.

NRTC—A Cooperative

NRTC operates on a not-for-profit basis. We serve our members and affiliates who in turn provide the retail DirecTV service to the rural marketplace.

NRTC supports more than 1,000 rural utilities and affiliates located in 46 states. Many of these entities deliver telecommunications and information technology solutions to their communities. These NRTC members and affiliates serve more than 35 million customers in areas of the country that have been historically unserved or under-served by traditional utilities and other businesses.

Building on a foundation of community service, we work, as a cooperative, to ensure that all rural Americans share equally in the benefits of the digital age. We see ourselves, at NRTC, as builders, and we want to continue this tradition.

I also want to say that I have a great deal of respect for people who are builders, and accordingly, I want to acknowledge Mr. Ergen. He has built a very strong and important business in EchoStar. We are out there directly competing with his company each day. He aggressively prices and provides service to consumers. He keeps us on our toes. We respect him as a competitor. If this merger is successful, however, he will also be NRTC's exclusive

wholesale supplier—and that raises serious concerns for our rural customers by reducing the current choice of satellite services from two to one, and by eliminating all effective and meaningful competition in rural America.

**For Many Americans With No Access To Digital
Cable Television
This Proposed Merger Creates a Monopoly Provider of Services**

Rural America includes many areas where no cable company exists to provide video television service. In other areas, only analog cable is available. In both instances, consumers must rely solely upon satellite services for delivery of digital programming. For these rural Americans, the merger of the number one and number two competitors in the high powered digital direct broadcast satellite (DBS) market, without any third provider, creates a monopoly.

We believe the Committee should carefully weigh the following facts:

- As many as 19% of U.S. housing units have no access to cable TV service, according to a U.S. Department of Commerce National Telecommunications and Information Administration (“NTIA”) and the Rural Utilities Service (“RUS”) Report issued in April of 2000. On October 30, 2001, The New York Times estimated that 22% of U.S. homes did not have access to a video cable provider. A copy of the report and article are attached to my testimony. Whether it is 19% or 22%, it still means tens of millions of American households will be without competition.
- The same New York Times article estimated that 20 states have less than 70% cable access. For these areas the DirecTV-EchoStar merger, if permitted, creates a monopoly of one, which will choose the service offerings, pricing and the content of all programming packages.

These facts are beginning to generate concerns on the part of state antitrust officials and others impacted by the potential merger. For example, Missouri's Attorney General, Mr. Jay Nixon, has recently written to U.S. Attorney General Ashcroft, expressing his office's concern that nearly 850,000 homes in his state - fully one-third of Missouri's population - must rely solely upon the proposed merged company for multi-channel video services if the merger is permitted.

**If This Merger Is Permitted, Delivery of
Broadband Internet Services to Rural America
Will Be Severely Impacted**

The future of Broadband Internet access to rural America is threatened by this proposed merger. There are three likely sources of broadband services in rural America – satellite, cable or telephone companies. Because of the low population density in many areas of rural America, satellite is the only potential broadband provider in much of rural America. Portions of rural America will remain on the wrong side of the digital divide if Broadband Internet isn't available at reasonable costs. This proposed merger, if approved, will leave one company controlling the availability, breadth and cost of nearly all satellite Broadband Internet (and video) services to rural America. There are currently two providers of this service in the market today, Direcway (owned by Hughes), and Starband (controlled by EchoStar). The merger would create a monopoly in a market that is still forming. The next generation of Ka-band service, which will have greater capacity, faster speeds and lower costs--if offered in a competitive market--will be dominated by the proposed merged entity. Any other competitors are likely to be frozen out of the market. There is already evidence that this is occurring. Meanwhile, EchoStar just completed its purchase of 90% of Visionstar, another potential Ka-band provider. The market reality is that any satellite broadband provider also needs to offer video services. Without video

competition, there will be no broadband competition. Said differently, if this merger is approved as proposed, all roads will lead to EchoStar.

**EchoStar and Hughes' Claims Of Potential Price Guarantees
To Rural America Are Currently Meaningless And Unenforceable**

Prices of digital video services will go up in rural America because of this merger. Whether it be video or broadband service, if there is no effective competition, prices will be set by the monopoly provider. The claim has been made that the new monopoly will chose to sell its video service at the same price in rural America as it does in urban areas where there is competition. These half made promises of price guarantees are no substitute for genuine competition.

EchoStar and Hughes have made claims they may extend pricing in Manhattan, Chicago and Los Angeles to customers in rural Missouri, Texas, Virginia and Wisconsin. This promise is supposed to mollify the concerns of your rural constituents who will find themselves in a monopolistic world regarding video and broadband services. But setting that concern aside, no legally enforceable promise has been made. If the Members of this Committee, the antitrust authorities of the Justice Department, and the FCC's Commissioners are to take these representations seriously, Hughes and EchoStar should make their half promise more definite.

Will the proposed merged entity promise to set rural prices at the level of its lowest urban prices? Will the proposed merged entity provide rural consumers new services, such as broadband services, at the lowest urban price? If the proposed merged entity provides urban America with free installation for a thirty day promotion, will rural Americans benefit from the offer?

Currently the set top box technologies used by DirecTV and EchoStar are incompatible, and the customers' dishes are pointed towards different satellites. Will the proposed merged entity really provide new set top boxes and re-point consumers' dishes at satellites for no cost to the consumer as they have implied? We have estimated that the cost of this switchout will be in excess of \$5-6 billion, although we have seen much smaller cost estimates proposed. We believe having accurate cost estimates here is critical, because promises to pay without a direct or indirect contribution from the consumers will become increasingly unrealistic as the cost goes up. Does anyone really think the consumers will not be charged, directly or indirectly, for these multi-billion dollar merger related costs? We also wonder if anyone has fully assessed the massive consumer disruption which will be caused by the proposed switchout.

We believe enforcement of the half promise about pricing is a potentially insurmountable problem. No agency of this government is currently enforcing such a promise. For these reasons, we at NRTC believe this promise has been made for its appealing nature, not because it ensures meaningful protection for rural Americans.

Price Isn't Everything

But even if some form of "universal pricing" can meet the requirement for enforceability and realism, it is only one issue of many that concerns consumers. We know our customers. They are not solely concerned with price alone. Quality of service is equally important. If a subscriber's system is broken, they want it fixed. If a subscriber has a question about his billing, he wants it fixed. Service under monopolies traditionally declines because of the lack of competition. If you can't go anywhere else, there is no economic imperative to provide good service. No promise solves this problem.

Today's pre-merger competitive marketplace protects the consumer. No price solution, no matter how construed or implemented, can substitute for the choice and competition that exists today.

One Source Of Programming In Rural America Is Not Enough

Currently, DirecTV and EchoStar each provide alternative video programming. If the merger is approved, rural Americans will only be able to see what DirecTV chooses to deliver. Will certain news programs be made unavailable? Will certain program sources be kept out of reach for any reason? Two or more sources of programming protects access, preserves choice, and assures competition for rural Americans.

Just last week EchoStar announced they would no longer offer ESPN Classic or ABC Family channels. What happens if EchoStar decides other programming -- such as CNN, HBO or C-Span -- costs them too much? Where can rural residents go for that programming?

Local-To-Local Coverage Is Important, But This Merger Cannot Be Justified By Its Promised Delivery

There are only three U.S. orbital locations capable of nationwide service (aka "CONUS"—for Continental U.S. frequencies), and they are located at 101° west longitude (WL), 110° WL and 119° WL. Each CONUS slot is authorized to utilize up to 32 frequencies, for a total of 96 total DBS frequencies which can reach the whole country. Today, DirecTV has 46 CONUS frequencies, and EchoStar has 50.¹

¹ In addition, EchoStar also owns the following assets: in the Ku-band, 61.5° WL, 11 of 32 frequencies; 148° WL, 24 of 32 frequencies; 175° WL, all 32 frequencies; in the Ka-band, 121° WL, 500 MHz, 113° WL, 1000 MHz; 109.2° and 73° WL, some ownership; and 83° WL, 500 MHz.

Earlier this year, an expert chosen by the U.S. Department of Justice, Mr. Roger J. Rusch, publicly stated that DirecTV and EchoStar are the “two dominant DBS providers in the United States” who collectively own all three of the most desirable satellite orbital locations for broadcasting video services. This Department of Justice expert testified in a written declaration that the two DBS providers could retransmit all high power television stations in the U.S. to local communities using existing technology. He further stated that the dedicated use of as few as 12 frequencies could be utilized by each company today to distribute all 1475 local television stations to local communities. A copy of this Department of Justice affidavit is attached to my formal testimony. Therefore, one of the major claimed benefits of this merger – the expanded provision of local-to-local coverage -- could be done by both companies individually today, according to the U.S. Department of Justice’s own expert. Based upon this analysis, the merger is not necessary to expand local-to-local coverage since DirecTV and EchoStar each have enough spectrum to offer all the local channels. They have chosen not to do so.

Apart from the Department of Justice view, the proposed merged entity has indicated it will increase on a selective basis local-to-local coverage. Which specific markets will be receiving local-to-local services is not set in stone or guaranteed at this time. Any expansion of local-to-local service is laudable, but it leaves those designated market areas (DMAs) that are not served without coverage. No promise has been made to these citizens about when, or even if, they can receive service. On the other hand, competition between an independent EchoStar and an independent DirecTV is more likely to yield coverage for all local-to-local broadcasts as they aggressively compete for new subscribers by offering highly desirable local programming. Provision of such broadcasts has been an important differentiator in their respective service offerings. If the economics are not there today to encourage service to the last 100 marketplaces, the monopoly that results will have no reason to extend service in the future.

Past Monopoly Claims By EchoStar Against Its Proposed Merger Partner Merit Careful Review

As recently as two months ago, EchoStar was engaged in a lawsuit which accused DirecTV of being a monopoly that repeatedly abused its monopoly power. Attached to my testimony you will find a copy of EchoStar's complaint against DirecTV. I believe you will be particularly interested in reviewing EchoStar's characterization of the uniqueness of the DBS marketplace² and their allegations of DirecTV's abuse of its power which permeate the document. Of course, the proposed merger partners dismissed this suit when they decided to marry their corporations. But if DirecTV constituted a monopoly, please think carefully about the resulting single entity's overwhelming market power.

Northpoint Is Not An Answer To Rural Competitive Needs

Northpoint is a start-up company with no operating history, no revenue, no experience delivering its proposed service, and no FCC license. It is seeking a terrestrial license to operate in the same Ku-band spectrum as EchoStar and DirecTV, which have opposed the request. It would operate somewhat similar to MMDS, using large antenna towers which could be viewed by households with a clear line of site to the antennas. There are several significant impediments to Northpoint ever coming to market.

One main impediment to Northpoint coming to market is that its technology interferes with DirecTV's and EchoStar's DBS signal. An independent study commissioned by the Congress and the FCC was performed on Northpoint by the MITRE Corp. That study found Northpoint's technology caused interference with a customer's reception from satellite services.

² Of particular interest are paragraphs 26, 28, 34, 52, 56 and 57.

It further found that the interference could be reduced if certain mitigation measures were undertaken, some of which are quite costly. It is unclear whether Northpoint has sufficient financing to undertake these remedial measures.

Another significant impediment is that Northpoint's FCC application seeks a license for free, instead of under the FCC's usual method of auctioning off valuable spectrum. Northpoint's CEO has intimated that the company cannot afford to roll out its product if it has to pay for the spectrum. It is unlikely that the FCC will, or should, give away valuable spectrum.

Even if Northpoint obtains a license and makes it to market, which is speculative at best, it is unlikely that Northpoint would be a significant or effective competitor in rural America because of the high costs for building large antenna towers that would serve very few rural households.

Antitrust Law Should Block This Merger as Proposed

Claims that a merger will generate efficiencies in one market cannot justify or offset anti-competitive effects created by that merger in a separate market. This conclusion follows from the language of Section 7 of the Clayton Act, which prohibits mergers or acquisitions which may substantially lessen competition "...in any line of commerce or...in any section of the country..." Thus, Section 7 presents a legislative conclusion that one section of the country will not be sacrificed to anti-competitive effects in order to generate a benefit for a different section of the country. This hearing reaffirms that conclusion in its own way.

This statutory language was relied upon by the United States Supreme Court in United States v. Philadelphia National Bank, 374 U.S. 321 (1963), where the Court explained that a merger leading to anti-competitive effects in one portion of the country could not be justified by arguable pro-competitive benefits to another section of the country. The Court stated: "If anti-

competitive 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.” The Supreme Court enjoined the proposed merger.

The area of effective competition is the geographic area where customers can practically turn for alternative sources of the product. Anti-competitive effects in one market, such as rural America, cannot be shrugged off or disregarded, even if there is allegedly a benefit in another market.

Conclusion

Just a few years ago there were four competitors in the satellite market. Then Hughes bought Primestar. Hughes then bought USSB. If EchoStar is permitted to buy Hughes, there will be only one. One supplier is a lonely number for a rural consumer. As it is currently proposed, the merger of two highly successful DBS companies³ with huge market value is so anti-competitive with respect to rural America that it should not be permitted in its current form. If this merger is permitted in its current form, it would appear that there is little or nothing left to antitrust policy and enforcement in the first years of the 21st Century.

I am grateful for your attention and I look forward to responding to your questions.

³ On November 15, 2001, Hughes stated its 2002 revenues would expand from \$8.3 billion in 2001 to \$9.2 billion in 2002; that its earnings will double; and it will add 1.2 million new subscribers.