NEWS

Federal Communications Commission
445 12th Street, S.W.
Washington, D. C. 20554

News media Information 202 / 418-0500
Fax-On-Demand 202 / 418-2830
TTY 202/418-2555
Internet: http://www.fcc.gov
ftp.fcc.gov

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NEWS MEDIA CONTACTS:
Michelle Russo 202-418-2358
David Fiske 202-418-0513

FCC DECLINES TO APPROVE ECHOSTAR-DIRECTV MERGER

Today, the Federal Communications Commission ("FCC") declined to approve the transfer of licenses from EchoStar Communications Corporation and Hughes Electronics Corporation, a subsidiary of General Motors Corporation, to a new entity. The FCC said that the companies have not demonstrated that approval of the transaction will serve the public interest, convenience, and necessity.

In an Order designating the application for a full evidentiary hearing before an Administrative Law Judge, the FCC ruled that the likelihood of the merger harming competition in the multichannel video program distribution ("MVPD") market outweighs any merger-specific public interest benefits. The FCC found that such a loss of competition within the MVPD market is likely to harm consumers by: (1) eliminating an existing viable competitor in every market; (2) creating the potential for higher prices and lower service quality; and (3) negatively impacting future innovation.

The FCC said the combination of EchoStar and DirecTV would eliminate existing facilities-based intramodal competition and replace it with a proposed "national pricing" plan, which would have to be enforced by regulatory authorities. The FCC said the effect would be to replace facilities-based competition with regulation, which is not consistent with either the Communications Act or with long-standing policy, both of which aim at replacing regulation with free market competition.

In addition, the FCC said the record does not support a conclusion that the combined spectrum resources of EchoStar and Hughes/DirecTV are necessary for deployment of viable satellite-delivered broadband services. Furthermore, the FCC found that the proposed merger is inconsistent with well-established pro-competitive spectrum policies and the elimination of an alternative MVPD provider in every market in the country may disserve the FCC's policy of viewpoint diversity.

The FCC provided Applicants 30 days to file an amended application to ameliorate the FCC's anti-competitive concerns and to file a petition to delay the hearing. A summary of the FCC's analysis is attached.

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Action by the Commission, October 9, 2002, by Hearing Designation Order (FCC 02-284). Chairman Powell, Commissioners Abernathy and Copps issuing separate statements, Commissioner Martin approving in part, concurring in part, dissenting in part and issuing a statement.

Media Bureau Staff Contacts: Barbara Esbin, Marcia Glauberman at 202-418-7200.

FCC DECLINES TO APPROVE ECHOSTAR-DIRECTV MERGER
SUMMARY OF FCC'S ANALYSIS
RELEASED: OCTOBER 10, 2002

GENERAL BACKGROUND

The proposed transaction involves the split-off of Hughes Electronics from General Motors Corporation, followed by the merger of the Hughes and EchoStar companies. The proposed merged entity, "New EchoStar," would have a new ownership structure and would continue to provide DBS subscription television service under the DirecTV brand name. If approved, the proposed merger would combine operations of the two major direct broadcast satellite ("DBS") providers in the United States – EchoStar and DirecTV, a wholly-owned subsidiary of Hughes – into a single entity. In addition to acquiring the significant DBS operations of EchoStar and DirecTV, New EchoStar would acquire other significant satellite operations of Hughes, including Hughes Network Services, Inc., a leading facilities-based provider of very small aperture terminal network systems, and PanAmSat Corporation, a leading global facilities-based provider of geostationary-satellite orbit FSS.

SUMMARY OF KEY POINTS IN FCC'S DECISION

- ✓ The companies have not demonstrated that approval of the transaction will serve the public interest, convenience and necessity.
- ✓ The FCC ordered the application to be designated for hearing before an Administrative Law Judge.
- ✓ In almost all areas reached by cable, the number of competitors would drop from three to two. In almost all other areas, the proposed transaction would create an effective monopoly.
- ✓ Courts applying the antitrust laws have not looked kindly on mergers to duopoly, especially in markets characterized by high barriers to entry, because those mergers often result in less competition, higher prices, less innovation, and fewer consumer benefits.
- ✓ The promised benefits are not supported by the data supplied; are not merger-specific; or are achievable through other means.
- ✓ Direct Broadcast Satellite service is a successful model of intramodal, facilities-based competition, which is a communications policy goal and FCC priority.
- ✓ The proposed "national pricing" plan is at best unlikely to be effective to protect consumers and at worst could exacerbate likely competitive harms of the merger.
- ✓ These are not failing firms. Both DirecTV and EchoStar continue to enjoy growth rates that many companies would envy, while the growth rates for cable are essentially flat.

Public Interest Analysis

The FCC's public interest analysis requires a broad consideration of federal communications policy – a policy shaped by Congress and deeply rooted in a preference for competitive processes and outcomes. The FCC's public interest standard includes an evaluation of the effect of the proposed transaction on competition, consistency with its spectrum policies, and in the case of MVPD services, a consideration of the impact on program and viewpoint diversity.

Harmful Effects on Competition

With regard to competition, the record irrefutably demonstrates that the proposed transaction would have the following effects:

- Eliminate a current viable competitor from every market in the country, whether those markets are currently served by cable systems or are markets in which no cable systems exist. Nearly every American household would effectively face either a duopoly or a monopoly.

- Such a loss of competition within the MVPD market is likely to harm consumers by: (1) eliminating an existing viable competitor in every market; (2) creating the potential for higher prices and lower service quality; and (3) negatively impacting future innovation.

- Combine two DBS providers that are currently fairly evenly balanced in terms of the assets necessary for effective competition in the MVPD market. Each has, over a number of years, at great expense, acquired the necessary spectrum and licenses; developed and deployed the necessary equipment (satellites, earth stations, and consumer premises equipment); developed the necessary resources for marketing and consumer support; and acquired a substantial base of consumers.

- Each company holds licenses for approximately half the total orbital slots available for the provision of DBS service to the entire continental United States—licenses they seek in this proceeding to transfer to a single new entity. Accordingly, the barrier to entry for any entity seeking to compete in the market for satellite provision of MVPD service would be enormous.

Replacing Competition with Regulation

- The combination of EchoStar and DirecTV would eliminate the viable facilities-based intramodal competition that characterizes the DBS service today, and replace it with the proposed "national pricing" plan, which must be enforced by regulatory authorities. In other words, the effect would be to replace facilities-based competition with regulation.
- The proffered national pricing plan is unlikely to cure the anticompetitive effects of the merger in areas unserved by any other MVPD provider, and may in fact exacerbate harmful competitive effects.
- Replacing facilities-based competition with regulatory oversight is not consistent with either the Communications Act or with contemporary regulatory policy and goals, all of which aim at replacing, wherever possible, regulatory safeguards with free market competition, and particularly with facilities-based competition.

Analysis of Proposed Benefits

The FCC determined that the majority of the companies' promised benefits appear to be inadequately supported by the data supplied; are not merger-specific; or are achievable through other means. In analyzing the proposed benefits of the transaction, the FCC reached the following conclusions.

Nationwide "local into local" service

- Separately, the companies could serve the top 100 markets, representing nearly 85 percent of the U.S. population.
- With the resulting high degree of concentration in all MVPD markets, the economic incentives to carry local broadcasts into local markets will be decreased, rather than increased.

Competition to Cable

- DBS companies are witnessing 20 percent annual growth; cable growth is flat.
- In rural areas, there is no cable, so competition would decrease, not increase.
- Regulation should not replace existing competition.
- The proposed transaction would produce a more capable but less effective competitor.

Broadband Market Competition

- Competition to cable modem and DSL products from satellite providers would be a significant advance, but the claimed efficiency benefit here is weaker than in the MVPD market.
- There is no spectral efficiency gain because each broadband customer uses additional spectrum, regardless of the number of providers.
- The companies have failed to substantiate that their claimed broadband benefit was likely to occur or that the merger was necessary to achieve it.

Spectrum Policy and Diversity

- The claims of improved spectrum efficiency have some validity in that the elimination of duplicative programming carriage will permit more efficient use of scarce spectrum resources.
- However, the record does not support further claims that this efficiency would result in public interest benefits cognizable under the FCC's merger review standard.
- Placing all of the available full-CONUS DBS spectrum licenses in the hands of one entity is inconsistent with the FCC's well-established pro-competitive spectrum policies.
- Elimination of an alternative MVPD provider in every market in the country, without any cognizable evidence of offsetting enhancement of viewpoint diversity, may disserve the FCC's policy of viewpoint diversity.

ADMINISTRATIVE LAW JUDGE HEARING

Section 309(e) of the Communications Act provides that if the FCC "for any reason" is unable to make a finding under Section 309(a) that the public interest would be served by the granting of a license transfer application, then "it shall formally designate the application for hearing on the ground or reasons then obtaining."

Pursuant to Sections 309(e) and 409(a) of the Act, the FCC designated the EchoStar-DirecTV merger application for hearing. The FCC is directing the Administrative Law Judge ("ALJ") to conduct an evidentiary hearing and to provide the FCC with an initial decision, taking into consideration the conclusions made in the Order along with any additional evidence developed at the hearing.

The item identifies specific issues to be addressed at hearing, and directs that Applicants will have the burden of proof both with respect to the introduction of any new evidence they may proffer and with respect to all of the issues. Pursuant to Section 1.276 of the Commission's rules, any party that disagrees with the ALJ's recommendation will have the opportunity to appeal it to the Commission, which will review the matter de novo. The item directs the ALJ, based on the guidance and findings made in the item, along with any additional evidence developed at the hearing, to determine whether the transfer of control to New EchoStar of the licenses and authorizations controlled by GM/Hughes and DirecTV and EchoStar is likely to cause any anticompetitive or other public interest harms, and to determine what, if any, public benefits would likely accrue from this transaction.

As a matter of process, the FCC provided the Applicants 30 days to file an amended application to ameliorate the FCC's concerns and to file a petition with the FCC seeking to delay the hearing.

SATELLITE APPLICATION

In this proceeding, the FCC also considered the joint application submitted by EchoStar and Hughes requesting authority to launch and operate NEW ECHOSTAR 1, a direct broadcast satellite that would be located at the 110° W.L. orbital location. EchoStar and Hughes propose, subject to and contingent upon grant of the Satellite Application, to launch and operate a spot beam satellite with other existing and planned satellites at the 110° W.L. orbital location on frequencies currently authorized to EchoStar and DirecTV. The Applicants claim that grant of the proposed Satellite Application would ultimately allow New EchoStar to offer local broadcast channels in all 210 television markets, or Designated Market Areas ("DMAs").

In addition to the specific issues the FCC designated for hearing, it also directed that the review of Applicants' proposed Satellite Application be undertaken within the context of the hearing proceeding.

TIMELINE OF FCC REVIEW OF PROPOSED ECHOSTAR-DIRECTV MERGER

December 21, 2001:	FCC review begins. FCC issues Public Notice seeking comment on merger application. 180-day clock starts.
February 4, 2002:	Public comments due to FCC. FCC issues Discovery request.
February 25, 2002:	Reply comments due to FCC.
March 7, 2002:	FCC Merger Review clock stopped pending Applicants' substantial compliance with Discovery Request (Day 77).
April 19, 2002:	New EchoStar 1 Satellite Application placed on Public Notice.
May 20, 2002:	Petitions to Deny/Dismiss Satellite Application due.
May 30, 2002:	Opposition to Petitions and Reply Comments due.
June 4, 2002:	Replies to Petitions due.
July 23, 2002:	Merger review clock re-started; Applicants found to have substantially complied with Discovery Request.
October 10, 2002:	FCC declines to approve proposed transaction (Day 157).

For more information on the FCC's review, see www.fcc.gov/transactions **or** fcc.gov/mb

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