APPENDIX C

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

Application of	)	
	)	
EchoStar Communications Corporation, General Motors Corporation, Hughes Electronics Corporation,	)))	
	)	
Transferors	)	CS Dkt. No. 01-348
	)	
and	)	
	)	
EchoStar Communications Corporation,	)	
	)	
Transferee,	)	
	)	
For Authority to Transfer Control	)	

REPLY DECLARATION OF J. GREGORY SIDAK

INTRODUCTION

1. When presented with the actual evidence of price competition between the two direct broadcast satellite (DBS) service providers, DIRECTV and EchoStar, Professor Robert D. Willig has modified his position substantially and supplemented his analysis. Before, based on

representations made to him by the DBS companies, he rejected the possibility of competition between DIRECTV and EchoStar. Now, Professor Willig acknowledges a "degree" of competition between DIRECTV and EchoStar. Before, he dismissed any anticompetitive effects. Now, Professor Willig invites the Commission to perform the following tradeoff: accept known consumer welfare losses today in exchange for unknown, unproven, and non-quantified efficiencies tomorrow. In doing so, he fails to carry the burden of demonstrating that the proposed merger's anticompetitive effects would be outweighed by any efficiency gains. The Commission should decline Professor Willig's invitation and instead should, as I proposed in my initial declaration, block the proposed merger.[1]

QUALIFICATIONS

2. My name is J. Gregory Sidak. I am the F.K. Weyerhaeuser Fellow in Law and Economics Emeritus at the American Enterprise Institute and the president and chief executive officer of Criterion Economics, L.L.C., in Washington, D.C. I have been a consultant on regulatory and antitrust matters to the Antitrust Division of the U.S. Department of Justice and the Canadian Competition Bureau and to more than forty companies in the telecommunications, computer software, electric power, natural gas, mail and parcel delivery, broadcasting, newspaper publishing, recorded music, and financial services industries in North America, Europe, Asia, and Australia.[2]

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1. Declaration of J. Gregory Sidak on behalf of the National Association of Broadcasters, CS Dkt. No. 01-348 (filed Feb. 4, 2002) [hereinafter *Sidak Declaration*].
2. My complete biography appears in my initial declaration. *See id.* at 3 ¶¶ 2-6.

3. I file this declaration in my individual capacity as a consultant to the National Association of Broadcasters and not on behalf of the American Enterprise Institute, which does not take institutional positions on specific regulatory, adjudicatory, legislative, or executive proceedings.

SUMMARY OF CONCLUSIONS

4. In this reply declaration, I evaluate arguments that Professor Willig made in his reply declaration on behalf of EchoStar and DIRECTV.[3] Mergers that reduce the number of competitors from 3 to 2 or from 2 to 1, such as the proposed EchoStar-DIRECTV merger, are highly likely to have anticompetitive effects, as my initial declaration and those of Professors Paul W. MacAvoy and Daniel Rubinfeld demonstrated.[4] Only if such a merger results in "extraordinary efficiencies" can these anticompetitive effects be overcome.[5] Professor Willig has failed to present specific analysis to counter either the presumption of anticompetitive effects or the estimates of the likely magnitude of such effects furnished in my initial declaration and the declarations of others, despite the fact that such data are within the control of EchoStar and DIRECTV. EchoStar and DIRECTV have failed to come forth with quantified estimates of post-merger efficiencies that would allow one to understand their countervailing impact, if any, on the predicted price increase.

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3. Reply Declaration of Robert D. Willig on behalf of EchoStar Communications Corp., Geneal Motors Corp., and Hughes Electronics Corp. (filed Feb. 25, 2002) [hereinafter *Willig Reply Declaration*].

4. Declaration of Paul W. MacAvoy on behalf of the National Rural Telecommunications Cooperative, CS Dkt. No. 01-348 (filed Feb. 1, 2002); Affidavit and Report of Daniel Rubinfeld on behalf of Pegasus Communications, CS Dkt. No. 01-348 (filed Feb. 4, 2002).

5 FTC v. H.J. Heinz Co.,246 F.3d 708, 720 (D.C. Cir. 2001).

5. In Part I, I rebut Professor Willig's characterization of the proposed merger as procompetitive. I show that Professor Willig has not offered credible analysis of the extent to which DIRECTV and EchoStar constrain each other's prices. The customer churn data on which Professor Willig relies are uninformative. I also show that Professor Willig and the DBS companies have failed to substantiate in any way the claimed efficiencies of the proposed merger, as is their burden, whether in the nature of cost savings or in the introduction of new services, and that the welfare gains from such efficiencies, if any, may be insubstantial.

6. In Part II, I show why the offer by EchoStar and DIRECTV to charge a uniform national price plan is not a panacea. The Commission cannot rely upon Professor Willig's analysis because it offers no assurance that the merged DBS firm would refrain from discriminating against rural DBS customers. Professor Willig's analysis ignores EchoStar's insistence that the merged DBS firm have the flexibility to respond to local promotions by cable television system operators. EchoStar's pledge not to price discriminate against rural customers is an empty promise. Moreover, on price and non-price dimensions a national pricing plan would be impossible for the FCC to enforce.

7. Finally, even if the merged DBS firm refrained from discriminating against customers in areas without cable television service, such a plan would be anticompetitive. The post-merger national price would exceed the pre-merger price in areas with cable television service. Furthermore, the national price would make it easier for the merged DBS firm to collude with cable television system operators.

I. Professor Willig Fails to Quantify His Estimates of Anticompetitive Effects and Potential Efficiencies

8. Professor Willig does not support his assertion that the proposed merger would be procompetitive on balance. His rebuttal of my analysis of the anticompetitive effects of the proposed merger relies on churn data that in no way counter the presumption that this merger, resulting in highly concentrated local markets, would be anticompetitive. Similarly, Professor Willig's attempt to show procompetitive efficiencies fails because it is limited to vague assertions with no attempt to quantify their worth to consumers. Thus, the DBS firms and their expert fail to carry their burden of proof that the proposed merger would not have an anticompetitive effect or that the anticompetitive effects would be overcome by countervailing efficiencies.

A. Professor Willig Offers No Relevant Analysis Regarding the Extent to Which DIRECTV and EchoStar Constrain Each Other's Prices

9. Professor Willig's initial declaration did not present any empirical evidence to support his claim that EchoStar and DIRECTV do not compete. In his reply declaration, Professor Willig presents survey data that purportedly represent (1) the choices of former DIRECTV customers and (2) the choices of new DIRECTV customers. After reviewing the data, I conclude that the churn data do not support Professor Willig's assertion that DIRECTV does not exert pricing pressure on EchoStar (and vice versa).

1. Professor Willig Has Changed His Position and Now Concedes That DIRECTV and EchoStar Compete

10. In his initial declaration, Professor Willig asserted that DIRECTV did not consider EchoStar's price when forming its own price (and vice versa).[6] Faced with massive new evidence that contradicted what EchoStar and DIRECTV managers told him, Professor Willig modified his assessment of competition between DIRECTV and EchoStar:

> [The commenters] argue that if [DIRECTV and EchoStar] compete at all, the merger will have a significant and adverse effect on competition in the [multichannel video programming distribution (MVPD)] market. The more relevant question for analyzing the impact of the merger on competition in the MVPD market, however, is not whether they compete at all. Rather, it is the *degree* of competition between DIRECTV and EchoStar in a market including DBS providers, cable operators, other MVPD providers, and perhaps even broadcast television.[7]

Professor Willig has changed his position but continues to minimize the extensive competition between the DBS companies. He attempts to dismiss three of the eight anecdotes of head-to-head DBS competition that I presented by suggesting that other events, such as the passage of the Satellite Home Viewer Act, could have provided the impetus for the firms' correlated pricing and marketing behavior.[8] The fact that outside factors may have been the impetus for the timing of particular competitive announcements does not mean that they are not instances of competitive behavior. In any event, Professor Willig's failure to address the remaining five anecdotes of documented competition between DIRECTV and EchoStar speaks for itself.

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6. Declaration of Robert D. Willig on behalf of EchoStar Communications Corp., General Motors Corp., and Hughes Electronics Corp. ¶ 11 & n.5 (filed Dec. 3, 2001) (claiming that a DBS firm focuses on cable prices and that the other DBS provider "plays little (if any) role in their own pricing decisions") [hereinafter *Willig Declaration*].

7. *Willig Reply Declaration, supra* note 3, ¶ 59 (emphasis added).

8. *Id.* at ¶ 57-58.

2. The Customer Data That Professor Willig Cites Are Uninformative

11. In addition to modifying his opinions on the existence of competition between DIRECTV and EchoStar, Professor Willig supplements his earlier analysis. In his initial declaration, Professor Willig did not present any empirical evidence that DIRECTV and EchoStar fail to constrain each other's prices. In his reply declaration, Professor Willig now advances two surveys: (1) a survey conducted by DIRECTV of its new subscribers and (2) churn data of former DIRECTV subscribers. According to the survey of new subscribers, nine percent of DIRECTV's new subscribers previously subscribed to EchoStar, but 61 percent of new DIRECTV subscribers are either previous or current cable television subscribers. Professor Willig notes that "[a]lthough such figures are not necessarily conclusive, they confirm the views expressed by DBS executives—namely that the 'objective of each firm is to gain market share by luring consumers away from the leading cable providers,' not the customers of the other DBS firm."[9] Because the sample was less than 100 DIRECTV customers, or less than one one-thousandth of one percent of all DIRECTV customers, the survey results cannot be used to support the claim that DIRECTV does not constrain the pricing of EchoStar. Moreover, the small number of former EchoStar subscribers among DIRECTV's current subscribers may be attributable to the fact that DBS service is relatively new and EchoStar did not enter the market until two years after DIRECTV.

12. Next, Professor Willig cites two sets of churn data of former DBS customers (one for August through November of 2000, and another for 2001) to support his claim that DIRECTV and EchoStar do not compete on the basis of price:

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9. *Id.* ¶ 61 (quoting *Willig Declaration, supra* note 6, ¶ 10).

> Among those subscribers sampled who disconnected between August 2000 (when the price increase was announced) and November 2000 and cited cost/price issues as their main reason for departing DIRECTV, 3.1 customers churned to cable and 1.2 customers churned to an antenna for every one customer who churned to EchoStar. One potential concern with this analysis is that the sample size is relatively small (under 100 respondents). Nevertheless, such evidence provides support for the conclusion that there is only limited competitive interaction between the two DBS firms.[10]

The churn data are not illustrative for several reasons. First, the survey respondents had the opportunity to switch to cable television service—but for approximately 29 percent of all DIRECTV customers, cable television is not a viable option.[11] Indeed, for some customers in rural areas, over-the-air broadcast television is not an option. For customers without access to cable television service, the survey is not informative.

13. Second, the small sample size in the first survey leads to unreliable results. In particular, a small sample tends to increase the sampling error, which is the difference between the sample and the population that exists only because of the observations that happened to be selected for the sample.[12]

14. Third, the amount of time that passed since the date on which the customer disconnected service could significantly alter the results of the churn survey. Because a DBS customer may keep an antenna in his home, such a customer may find it easier to use the antenna as a short-term solution than to order cable television service or DBS service from another provider. If the former DBS customer were surveyed too soon after disconnecting, then one would expect that customer to have switched from DBS service to over-the-air broadcast service.

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10. *Id.* ¶ 63. The 2001 DIRECTV churn data cited by Professor Willig lists 3.4 customers churning to cable and 1.6 to antenna for every one who churns to EchoStar. *Id.* ¶ 64.

11. Comments of DIRECTV, Inc., Annual Assessment of the Status of Competition in the Markets for the Delivery of Video Programming, CS Dkt. No. 01-129 (filed Aug. 3, 2001) [hereinafter *DIRECTV Comments*].

12. *See, e.g.,* GERARD KELLER & BRIAN WARRACK, STATISTICS FOR MANAGEMENT AND ECONOMICS 170 (Duxbury Press 4th ed. 1997). For a review of sampling variance, see WILLIAM H. GREENE, ECONOMETRIC ANALYSIS (MacMillan Publishing 2d ed. 1990)

15. Fourth, although Willig restricts his analysis to churn data for customers who cited a "cost or price reason" for leaving DIRECTV, such a reason cannot be interpreted with certainty as the proper economic experiment for determining the cross-price elasticity of demand. In particular, Professor Willig provides no evidence that, for the first set of churn data, the price of DIRECTV increased *while the price of EchoStar was held constant.* More likely, because DBS prices move in unison, the price of EchoStar's offering increased at roughly the same time, thereby making DBS in general less attractive than cable television service. Indeed, if consumers perceived DIRECTV and EchoStar to be perfect substitutes, and if the price of DIRECTV and EchoStar increased simultaneously, then one would expect DBS customers to churn to cable television. Hence, the churn data presented by Professor Willig are consistent with the hypothesis that consumers perceive DIRECTV and EchoStar to be perfect substitutes.

16. Fifth, even setting aside the above faults, the churn data still are relevant only to the degree to which an *existing* DBS customer perceives DIRECTV and EchoStar to be substitutes. When measuring the cross-price elasticity of demand, however, economists seek to ascertain the degree to which a *potential* customer perceives two goods to be substitutes. Because the DIRECTV churn data reveal nothing about the degree to which cable television customers or broadcast television customers perceive DIRECTV and EchoStar to be substitutes, Professor Willig's churn analysis cannot inform the Commission on the matter of the cross-price elasticity of demand.

17. Sixth, broadcast television should not be included in every local MVPD market. For homes that cannot receive a clear signal from a rooftop antenna, broadcast television is not an option. Moreover, it is unlikely that a hypothetical monopoly provider of cable television service and DBS service would need to control the supply of broadcast television service to raise

prices above the competitive levels.[13] Indeed, because broadcast television service is essentially free to individuals who already own a television set, Professor Willig's argument is equivalent to the claim that, because soda drinkers occasionally "churn" to tap water, a hypothetical monopoly provider of soda would need to control the supply of free tap water to raise soda prices above the competitive level. In summary, Professor Willig is obscuring the key fact about competition—that it occurs at the margin.

3. Professor Willig's Justification for Examining the Effects of the Proposed Merger between EchoStar and DIRECTV at the National Level Is Not Valid and Is Not Consistent with His Reasoning in Other Regulatory Matters

18. In his initial declaration, Professor Willig argued that the relevant geographic market was the nation because the DBS firms priced their offerings in a uniform fashion.[14] In his reply declaration, Professor Willig stated that Pegasus, a retailer for DIRECTV in rural areas, charged an additional $3 above DIRECTV's own monthly subscription fee.[15] Because prices for DIRECTV service vary according to geographic area, Professor Willig's rationale for analyzing the competitive effects of the proposed merger at the national level is not valid. Later, in his reply declaration, Professor Willig agrees with me that the merged DBS firm would formulate its uniform price based on a weighted average of the competitive conditions in each local DBS

13. U.S. Dept. of Justice and Federal Trade Commission, Horizontal Merger Guidelines §§ 1.1 (rev. Apr. 8, 1997) [hereinafter *Merger Guidelines*].

14. *Willig Declaration, supra* note 6, at 11, ¶ 19("Finally, for the purposes of evaluating the competitive impact of the proposed merger, the national pricing for monthly subscription and programming fees by both EchoStar and DIRECTV suggest that a national-level analysis is the most appropriate . . . .").

15. *Willig Reply Declaration, supra* note 3, at 61, ¶ 93.

market.[16] That concession by Professor Willig undermines his claim that the relevant geographic market is national.[17]

19. Indeed, in a separate expert declaration filed on behalf of AT&T in February 2002, Professor Willig argues that competition in the broadband Internet market should be evaluated at the local level, especially in local areas not served by cable television service:

> [I]t is not enough to look at national statistics about DSL and cable modem subscriptions. Nationally, cable modem subscriptions have outpaced DSL subscriptions by nearly two to one . . . If one looks at smaller geographic markets, the differences are even more pronounced, for there are areas where cable service is not available at all, just as there are areas without DSL service . . . Thus, even if the Commission were to conclude that the ILECs lack market power in neighborhoods served by both DSL and cable, that analysis would not apply to the areas and customers who do not have such competitive choices.[18]

It is unclear why Professor Willig believes that competition in the market for broadband Internet services should be examined at the local level (when his client is seeking regulatory actions) while competition in the market for MVPD services should be examined at the national level (when his client is seeking de-regulatory actions).

B. DIRECTV and EchoStar Bear the Burden of Demonstrating That the Proposed Merger Would Produce Efficiencies

20. Professor Willig incorrectly suggests that the merger opponents bear the burden of estimating the size of merger-related efficiencies. Citing my initial declaration, he states: "Opponents of this merger have not disputed [the assertion that the merged firm's programming costs would be lower], but only dispute whether the size of these savings would be large enough

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16. *Id.* at 27 ¶ 39 ("For example, if I assume for simplicity that New EchoStar engages in differentiated products Bertrand price competition with cable and other MVPD providers in K geographic markets . . . .").

17. Professor Willig suggests that larger markets would receive a greater weight because EchoStar is experiencing faster growth in those markets. *Id.* at 29, ¶ 42. However, this assessment ignores the effect of local broadcast service offerings on growth. If smaller markets were to receive local broadcast service, then those markets might grow faster than the larger markets, and hence they would receive a greater weight in EchoStar's pricing formulation.

to outweigh any risk of a price increase after this merger. However, these opponents *have not attempted to quantify* the size of these cost savings."[19] It is not the job of the merger opponents to do so. Professor Willig has it backwards: with respect to claims of post-merger efficiencies, the merging parties—not the opponents or the government—bear the burden of proof.[20] Indeed, when the proposed merger generates a high market share in a given geographic area, the merging parties bear the burden "to produce evidence that 'show[s] that the market-share statistics [give] an inaccurate account of the [merger's] probable effects on competition' in the relevant market.)."[21] DIRECTV and EchoStar fail to carry that burden in this case by their proffer of Professor Willig's two declarations. For instance, although Professor Willig claims that the DBS companies have many programming contracts with volume discount clauses, he does not in any way "attempt to quantify" the size of those discounts and the extent to which marginal costs would decline.

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18. Declaration of Robert D. Willig on behalf of AT&T Corp., in Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services, CC Dkt. 01-337 at 20, ¶ 35 (filed Feb. 28, 2002).

19. *Willig Reply Declaration, supra* note 3, ¶ 19 (emphasis added) (citing *Sidak Declaration, supra* note 1, ¶¶ 92-94).

20. *See, e.g.*, FTC v. University Health, Inc., 938 F.2d. 1206, 1223 (11th Cir. 1991) ("a defendant who seeksto overcome a presumption that a proposed acquisition would substantially lessen competition must demonstrate that the intended acquisition would result in significant economies and that these economies ultimately would benefit competition, and hence, consumers"). *See also* Department of Justice and Federal Trade Commission, 1992 Horizontal Merger Guidelines (Apr. 2, 1992) at § 0.1 n.5 ("[T]he burden with respect to efficiency and failure continues to reside with the proponents of the merger."); Department of Justice and Federal Trade Commission, 1997 Horizontal Merger Guidelines (Apr. 8, 1997) at § 4.0 ("Therefore, the merging firms must substantiate efficiency claims so that the Agency can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so), how each would enhance the merged firm's ability and incentive to compete, and why each would be merger-specific.").

21. FTC v. H.J. Heinz, Co., 246 F.3d 708, 720 (D.C. Cir. 2001) (quoting United States v. Baker Hughes Inc., 908 F.2d 981, 982-83 (D.C. Cir. 1990)).

21. In August 2001, EchoStar offered to pay an 18 percent premium over Hughes's then-current stock price for DIRECTV.[22] Based on its original offer price, the premium amounted to an expected increase in profits of $4.9 billion (equal to $32 billion less $32 billion divided by 1.18). In my initial declaration, I estimated that the wealth transfer from DBS consumers to the merged firm ranged from $300 million (under Cournot competition) to $600 million per year (under perfect collusion),[23] which translates into a present discounted value that ranges from $2.0 to $4.0 billion over the next ten years.[24] Stated differently, I estimate that between two-fifths and four-fifths of EchoStar's expected increase in profitability is attributable to an expectation of increased market power. Given that potentially more than half of the premium can be explained by an expectation of increased market power, there is little chance that an efficiency defense can prevail.

1. Professor Willig Fails to Quantify The Claim of Programming Savings

22. Professor Willig claims that, as a result of the proposed merger, New EchoStar's programming costs would decrease due to volume discounts. That may or may not be true, as I discuss below, but most significantly, Professor Willig fails for a second time to quantify those alleged cost savings in any fashion or to substantiate his claim in any way. The repeated failure to provide verifiable evidence of programming cost savings, when the burden is clearly placed

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22. Nikhil Deogun & Andy Pasztor, *EchoStar Plans to Launch $32 Billion Bid for Hughes*, WALL ST. J. EUR., Aug. 6, 2001, at 1 (EchoStar offered 0.75 of its shares for each share of Hughes, which amounted to a valuation of Hughes at $22.83 per share).

23. *Sidak Declaration*, *supra* note 1, at Table 3.

24. There is a growing literature that examines the relationship between the acquisition premium and market power. *See, e.g.*, Allan J. Cox & Jonathan Portes, *Mergers in Regulated Industries: The Uses and Abuses of Event Studies*, 14 J. REG. ECON. 1 (1998) (using event-study analysis to evaluate the merger of SBC Communication and Pacific Telesis); Serdar Dalkir & Frederick R. Warren-Boulton, *Reading the Leaves, Spreading the News: Event-Probability Studies of Mergers in (De-) Regulated Industries*, Working Paper (Apr. 2001) (analyzing the stock price movements of competitors of WorldCom and Sprint to gauge the competitive effect of a merger).

on the merger applicants to do so, should cause the Commission to disregard this claim of alleged cost savings.

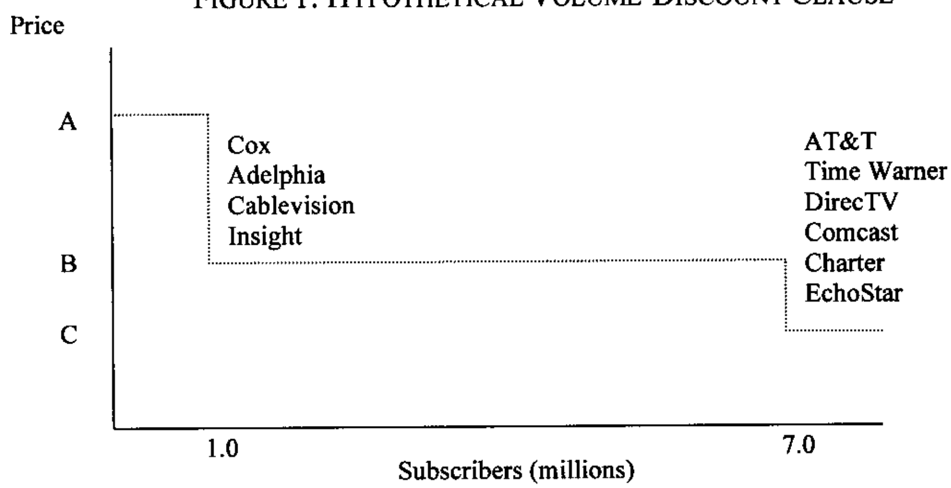
23. Further, Professor Willig's attempt to characterize efficiencies related to programming costs as "merger-specific" does not follow from the facts that he cites. He claims that "this efficiency is merger-specific because neither DBS firm would be able to achieve such programming cost savings on its own."[25] To illustrate his claims of merger-specificity, Professor Willig states that certain programming contracts entitle EchoStar or DIRECTV to the same prices as those received by MVPD providers with similar subscriber bases. Professor Willig fails to mention that, as of the end of 2001, DIRECTV and EchoStar already had the third and sixth largest MVPD subscriber bases, respectively.[26] In addition, a 1999 article by Professors Tasneem Chipty and Christopher Snyder documents empirically that cable operators that integrated

25. *Willig Reply Declaration, supra* note 3, ¶ 20.

26. Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, Eighth Annual Report, CS Docket No. 01-129, 17 F.C.C.R. at Table C-3 (2002) [hereinafter *Eighth Annual Report*]. At the end of 2001, AT&T had 17.0 million cable subscribers. AT&T Corp., *Group Earnings Commentary, Quarterly Update – Fourth Quarter 2001* (released Jan. 30, 2002) at 12 (downloaded from <http://www.att.com/ir/pdf/014q_cmnt.pdf> on Apr. 16, 2002). Time Warner had 16.1 million cable subscribers. Information downloaded from <http://www.aoltimewarner.com/companies/time_warner_cable_index.adp> on Apr. 16, 2002. DIRECTV had 10.7 million subscribers. Information downloaded from <http://www.directv.com/DTVAPP/aboutus/Investor.jsp> on Apr. 16, 2002. Comcast had 8.4 million cable subscribers. Comcast Corp., *Comcast to Debut HDTV in Major Markets By End of 2002*, Company Press Release, Mar. 14, 2002 (downloaded from <http://www.comcast.com/press_room/default.asp?subsection=pr cable_news#2002> on Apr. 16, 2002. Charter Communications had 7 million subscribers. Charter Communications, Inc., *Charter 2001 Pro Forma Cable Modem and Digital Customers Increase Nearly 165% and 82%, Respectively*, Company Press Release, Feb. 11, 2002 (downloaded from <http://www.onlinepressroom.net/chrtr/> on Apr. 16, 2002). EchoStar had 6.8 million subscribers at the end of 2001, and 7 million subscribers (as many as Charter) by Feb. 2002. EchoStar Communications Corp., *EchoStar Reports Record Fourth Quarter Revenue, EBITDA*, Company Press Release, Feb. 28, 2002 (downloaded from <http://www.corporate-ir.net/ireye/ir_site.zhtml?ticker=dish&script=410&layout=-6&item_id=263854> on Apr. 16, 2002). Cox had 6.2 million subscribers. Information downloaded from <http://www.cox.com/Corp/> on Apr. 16, 2002. Adelphia had 5.5 million subscribers. Information downloaded from <http://www.adelphia.com/about.cfm> on Apr. 16, 2002.

horizontally did not enhance their bargaining position vis-à-vis video programming suppliers.[27] Unless the DBS companies provide the Commission with the language from particular contracts with programmers, it is impossible to know whether New EchoStar would experience any cost savings. Figure 1 presents a hypothetical volume-discount package that would not generate any savings for New EchoStar.

FIGURE 1: HYPOTHETICAL VOLUME-DISCOUNT CLAUSE



Source: Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, Eighth Annual Report, CS Dkt. No. 01-129, 17 F.C.C.R. at Table C-3 (2002); EchoStar Communications Corp., *EchoStar Reports Record Fourth Quarter Revenue, EBITDA; EchoStar's DISH Network Satellite TV Service Reaches 7 Million Customer Milestone*, Press Release, Feb. 28, 2002.

Figure 1 shows three hypothetical volume discounts for distributors of multichannel video programming: (1) distributors with fewer than one million subscribers pay \$*A*; (2) distributors with more than one million but fewer than seven million subscribers pay \$*B*; and (3) distributors

27. Tasneem Chipty & Christopher M. Snyder, *The Role of Firm Size in Bilateral Bargaining: A Study of the Cable Television Industry*, 81 REV. ECON. & STAT. 326 (1999) ("Thus, our estimates of the supplier's surplus function call into question the popular claim that the prevalence of horizontal integration among cable operators is motivated by bargaining effects.").

with more than seven million subscribers pay $C. Under this hypothetical volume-discount clause, the proposed merger of DIRECTV and EchoStar would not generate any savings for New EchoStar.

24. Even if certain volume discounts were set above the DBS companies' current level of subscribers, internal growth would increasingly allow both DBS companies separately to take advantage of the volume-discount clauses that Professor Willig describes. DIRECTV and EchoStar have been the fastest growing firms in the MVPD industry. In an April 2002 SEC Form 8-K filing, DIRECTV announced that its sales had exceeded projections for the first quarter, and that it had added 342,000 net subscribers.[28] EchoStar has grown from 5.26 million subscribers at the beginning of 2001 to 7 million in February 2002, a growth rate of 33 percent in 14 months.[29] Indeed, the number of DBS subscribers is increasing at roughly 18 times the rate of increase in the number of cable subscribers.[30] Given this rate of growth, which far outstrips cable, the DBS carriers should be able to increasingly take advantage of whatever volume discounts in the purchase of video programming are available.

2. Professor Willig Presents No Evidence that the Offer of Local Services in All 210 DMAs Would Be a Merger-Specific Efficiency

25. In his initial Declaration, Professor Willig stated that the proposed merger would allow New EchoStar to provide services to 100 or more communities as compared to 40 now.[31] In his reply declaration, however, he now states that the proposed merger would allow service to

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28. HUGHES ELECTRONICS, 2002 FORM 8-K (Apr. 15, 2000); Subscriber total downloaded from <http://www.directv.com/DTVAPP/aboutus/Investor.jsp> on Apr. 17, 2002.

29. EchoStar Communications Corp., *EchoStar Reports Record Fourth Quarter Revenue, EBITDA*, Company Press Release, Feb. 28, 2002 (downloaded from <http://www.corporate-ir.net/ireye/ir_site.zhtml?ticker=dish&script=410&layout=6&item_id=263854> on Apr. 16, 2002).

30. NATIONAL CABLE AND TELECOMMUNICATIONS ASS'N, COMPETITION IN THE VIDEO MARKETPLACE IS HERE TO STAY 2-3 (Jan. 2002) (downloaded from < http://www.ncta.com/pdf_files/Competition.pdf> on Apr. 16, 2002).

all 210 DMAs, but that neither company could serve all 210 DMAs on its own because of additional costs and the necessity to forgo alternative services.[32] He also states that, although DIRECTV separately will have the technical capacity to offer local service to 103 DMAs, cost factors will limit it to 70 or fewer DMAs.

26. Professor Willig has no independent basis for these assertions and offers no evidence from the DBS firms to support them. To be credible, such statements would need to be backed by an analysis that would include a quantification of the private costs and benefits from adding a DMA. Professor Willig provides no data on any of these points, except for an estimate that DIRECTV would have to launch a new satellite for \$220 to \$300 million to serve all 210 DMAs.[33]

27. Nor does Professor Willig present evidence that this alleged benefit is merger-specific. Neither Professor Willig nor I are held forth as experts on engineering matters, so our opinions on technical matters are uninformative. However, it is worth noting that Professor Willig's conclusions are based on a static-state analysis. He assumes that there will be no further innovation leading to greater satellite capacity. Such an analysis does not comport with the experience of the DBS industry. Indeed, in the span of only a few weeks, EchoStar and DIRECTV were able to increase from 100 to 210 the number of DMAs that they believed they could serve economically if allowed to merge. This change in outlook by the two DBS firms raises the question of how many markets each firm might serve individually absent the proposed merger. EchoStar and DIRECTV have presented no evidence on this point, which makes it

31. *Willig Reply Declaration, supra* note 3, ¶ 24.
32. *Id.* ¶¶ 14-15.
33. *Id.* at ¶ 15.

impossible to assess to what extent their offer to serve all 210 DMAs is a merger-specific efficiency.

28. An additional reason to question whether this proffered efficiency is not achievable but for the proposed merger is the possibility that service to all 210 DMAs could be achieved through a production joint venture that would achieve the desired spectrum efficiencies without eliminating competition between the two DBS providers. The fact that the EchoStar and DIRECTV now propose to offer service to all 210 DMAs after the proposed merger suggests that they might find it economically rational to do so even without the proposed merger.

3. The Welfare Gains Associated with the Introduction of Additional Services May Be Insubstantial

29. Professor Willig's quest for additional merger-specific efficiencies leads him to posit a series of possible benefits, ranging from more specialized programming to a variety of enhanced services. A central problem with his recitation is that it entails no attempt to specify the value of such services to consumers. It is not clear that the value to consumers would be great. For instance, Professor Willig states:

> The spectrum efficiencies and expanded channel capacity resulting from the merger will allow New EchoStar to expand specialized programming offerings. Such programming could include ethnic, foreign language, educational, or other programs that appeal to specific audiences.[34]

Professor Willig does not mention that, as of April 2002, DIRECTV and EchoStar offered 250 national programs, including over 50 ethnic programs, foreign-language programs, and educational programs.[35] For the purpose of merger analysis, the relevant consumer benefit is not the consumer benefit from *all* ethnic, foreign-language, and educational programs. Rather, it is

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34. *Id.* ¶ 22.

the *incremental* consumer surplus that would be created by the next ethnic station, the next foreign-language station, or the next educational program. The concept of satiation is well recognized in the economic theory of consumer behavior.[36] Because DIRECTV currently offers 45 Spanish-language stations alone on its *DIRECTV Para Todos* package,[37] the incremental consumer surplus created by the next Spanish-language station, however large, would not likely compensate Hispanic DBS consumers for their welfare losses associated with higher DBS prices.

30. Furthermore, Professor Willig's assertion that the proposed merger would allow for investment in the creation of additional channels ignores the economic theory of fixed costs. A fixed-cost reduction is equivalent to a rich uncle—it is a *non*-merger-specific source of funding for the merged firm. Professor Willig does not explain why the fixed-cost reduction would be used to add channels, rather than being paid to shareholders as a dividend. Regardless of its source of the funding, a DBS firm will produce the next foreign-language channel *only* if it promises a return on investment that exceeds the firm's cost of capital.[38]

31. The other efficiencies that Professor Willig asserts would flow from the proposed merger are equally unsubstantiated. According to Professor Willig, the proposed merger would lower the fixed costs of the merged firm, thereby increasing the likelihood that new advanced services would be deployed. He suggests that this highly uncertain event, if it were ever realized, would bring enormous benefits to consumers: "Since *it appears* that consumers value the new

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35. Information downloaded from EchoStar's web site at www.dishnetwork.com and DIRECTV's website at www.DIRECTV.com on Mar. 13, 2002.

36. *See, e.g.*, HAL R. VARIAN, MICROECONOMIC ANALYSIS 98 (W.W. Norton 3d ed. 1992) (discussing diminishing marginal utility of consumption).

37. Information downloaded from http://www.DIRECTV.com/DTVAPP/learn/FAQ_DTVProgramming_Languages.jsp on Apr. 1, 2002.

services that New EchoStar will be able to offer once the spectrum duplication is eliminated, the consumer surplus gains from the increased availability of advanced services could potentially be quite substantial."[39] Professor Willig provides no evidence that (1) the proposed merger would lower fixed costs, (2) that the smaller fixed costs would facilitate the introduction of new services, and (3) that consumers would value the new services (let alone by how much). Professor Willig calls his own claim into severe doubt when, in the very next paragraph of his declaration, he acknowledges the low valuation that customers have placed on past "advanced" DBS service offerings:

> EchoStar and Hughes currently offer satellite-based Internet access products, but consumer acceptance of these products has so far been limited . . . . Despite the fact that satellite-based Internet access is technically available in all areas of the United States, the low penetration rate of this technology—even in areas without any access to DSL or cable modem service—raises questions about whether households in both rural and urban areas are likely to accept it on a large scale.[40]

Given Professor Willig's own analysis of consumer ambivalence toward satellite-based Internet access services, it is difficult to understand his basis for claiming that customers would value new advanced services supposedly made possible by a reduction in fixed costs owing to the proposed merger.

32. Consumers might value these "merger-specific" efficiencies modestly. For example, Professor Willig puts forward video-on-demand service as one example of an advanced service that would be provided if the proposed merger were approved. Existing DBS subscribers can already choose from over 100 stations of recent movie releases beginning every half-hour.

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38. More precisely, each DBS provider likely ranks projects according to their internal rate of return, and chooses those with the highest rankings. For a discussion of internal rates of return, see RICHARD A. BREALEY & STEWART C. MYERS, PRINCIPLES OF CORPORATE FINANCE 48 (McGraw-Hill 5th ed. 1996).

39. *Willig Reply Declaration, supra* note 3, ¶ 28 (emphasis added).

40. *Id.* ¶ 29.

The industry refers to this feature as "virtual" video on demand. Hence, to estimate the *incremental* consumer surplus of actual video-on-demand service, one would need to estimate the value associated with a consumer's saving on average fifteen minutes per downloaded movie.[41] Professor Willig presents no evidence that this savings would outweigh the consumer welfare losses that the proposed merger would inflict through higher DBS prices (and higher cable television prices).

33. In summary, Professor Willig pins the approval of the proposed merger on the premise that the unknown and unsubstantiated consumer welfare gains associated with additional programming and unproven, "advanced" services will outweigh the consumer welfare losses associated with the higher prices for (proven) DBS services. This proposition fails the Merger Guidelines requirement that cognizable efficiencies be verified, rather than "vague or speculative," a requirement of particular force when applied to a proposed merger to monopoly or near-monopoly, as here.[42]

II. The National Pricing Plan Is Not a Viable Safeguard

34. The Commission cannot rely upon Professor Willig's analysis of EchoStar's promise to charge a uniform national price after the proposed merger. There is no assurance that the merged DBS firm would not discriminate against rural customers. Even if the merged DBS

41. In March 2002, DIRECTV subscribers could watch *Pearl Harbor* for $3.95 beginning every half-hour. Information downloaded from DIRECTV's web site at www.DIRECTV.com on Mar. 13, 2002. If *Pearl Harbor* were available instantaneously through video-on-demand service, then the average subscriber who wanted to rent *Pearl Harbor* would decrease his wait time by fifteen minutes. Professor Willg might argue that the value of video-on-demand service is more than the instantaneous availability of recently released movies. But if DIRECTV were to make *all* movies available instantaneously, then the value of any subscription service like HBO would fall to zero. Clearly, such an outcome would not be in DIRECTV's interest.

firm did not discriminate against rural customers, DBS consumers in urban areas would face higher prices after the proposed merger.

A. The Commission Cannot Rely Upon Professor Willig's Analysis Because There Is No Assurance that the Merged DBS Firm Would Not Discriminate Against Rural Customers

35. For uniform pricing to protect rural DBS customers from higher prices, Professor Willig assumes that the merged firm would honor its pledge to price in a nondiscriminatory fashion. Because EchoStar insists on flexibility in the implementation of uniform pricing, and because the merged firm could break its pledge in subtle ways, the Commission cannot rely upon Professor Willig's analysis.

1. EchoStar Would Reserve the Right to React to Local Promotions by Cable Television Operators

36. Professor Willig's analysis ignores EchoStar's announcement in December 2001 that, under a uniform national pricing plan, the firm would still reserve the right to react to local promotions by cable television system operators. Mr. Charles Ergen, EchoStar's chief executive officer, has attempted to respond to concern about cable television systems' "cherry-picking" by saying that the merged DBS firm would not *really* implement a uniform national pricing plan. Instead, EchoStar would retain the ability to respond to price promotions and equipment rebates offered by cable television system operators in specific local markets: "if somebody comes in and offers a $300 rebate to get your customers in a particular location, then you have to have the

42. Department of Justice and Federal Communications Commission, Horizontal Merger Guidelines 1997, at § 4 (Apr. 8, 1997).

ability to respond to that."[43] But Mr. Ergen's insistence on retaining the ability to charge different prices in different local markets would, of course, eviscerate the "uniform" pricing plan.

37. Professor Willig repeatedly asserts that a uniform national pricing plan would "export" the competition from "more competitive DMAs,"[44] thereby allowing the benefits of competition with cable television systems to trickle down to customers in rural areas who are not offered cable television service. Professor Willig's analysis is inconsistent with Mr. Ergen's comment about his need for local pricing flexibility to respond to the competitive actions of cable television system operators. Indeed, it is difficult to understand how competition would be "exported" from urban to rural markets if, within the framework of a "uniform" and "national" pricing plan, the merged DBS firm retained the prerogative to respond to competitive pressures in specific geographic markets.

2. Because of the Multiple Ways That DBS Firms Compete on Price and Non-Price Dimensions, a Uniform National Pricing Plan Would Be Impossible to Enforce

38. Even under a uniform national pricing plan, there are at least four ways in which the merged DBS firm could discriminate against customers without access to cable television service. First, the merged DBS firm could vary the price of equipment or installation, or both. Second, the merged firm could offer rebates to customers who mail in their cable television bills. Third, the merged firm could reduce the number of channels available to customers in areas without cable television service. Fourth, the merged DBS firm could vary the price of local channels.

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43. *Ergen Makes His Case*, SATELLITE BUS. NEWS, Dec. 31, 2001, at 1 (quoting Charles Ergen) [hereinafter *Ergen's Statement*].

44. *Willig Reply Declaration*, *supra* note 3, ¶¶ 6, 34, 35, 38, 90, 107.

a. The Merged DBS Firm Could Vary the Price of Equipment or Installation, or Both

39. In response to my demonstration that the merged DBS firm could discriminate across geographic markets by varying the price of equipment and installation at the local level, Professor Willig argues that competition between local retailers and national retailers (like Circuit City and Best Buy) would protect consumers in areas without cable television service.[45] Professor Willig suggests that rural customers who live too far to drive to a national retailer could "take advantage of direct sales from New EchoStar, or could purchase their equipment over the Internet."[46] As of April 1, 2002, neither DIRECTV nor EchoStar made equipment purchases available over the Internet. Each firm requires the customer to contact a retailer in his local area. Moreover, because installation is a service and not a product, it would be impossible for the merged DBS firm to make installation available over the Internet.

40. Professor Willig also states that the existence of national retail chains that carry DBS set-top boxes would prevent the merged DBS firm from engaging in geographic discrimination: "Equipment is sold either directly by the DBS firms on a national basis, by local or regional retailers, or, in most cases, by large, national retail chains that also set a national price. These chains are present in so many areas that consumers, regardless of whether they have cable as an option, will be able to take advantage of the national offers."[47] Professor Willig incorrectly takes national chain stores' continued carriage of DBS set-top boxes as a given under a monopoly DBS provider when the current widespread carriage of DBS set-top boxes *results*

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45. *Id.* ¶ 103.
46. *Id.*
47. *Id.* ¶ 89.

from the current competition between DIRECTV and EchoStar.[48] Competition between DIRECTV and EchoStar induces each firm to pay commissions to national retailers in exchange for carrying that firm's set-top box. If DIRECTV and EchoStar did not compete with one another, there would be no reason for them each to offer a premium to the national chain for exclusivity. Mr. Ergen's stated interest in substantially reducing the commissions earned by national chains could prompt those same national chains to stop carrying DBS systems.[49] In contrast to Professor Willig's vision of DBS distribution after the proposed merger, consumers likely would not be able to take advantage of national DBS promotions through national retail chains.

b. The Merged Firm Could Offer Rebates to Customers Who Mail in Their Cable Bills

41. Professor Willig suggests that it is too difficult for EchoStar and DIRECTV to assess whether a customer has access to cable television service, and that the cost of erring—charging the higher DBS price to a customer who really has access to cable television service—is prohibitive.[50] To demonstrate how difficult detection is, Professor Willig cites a study by a Washington D.C.-based research firm, which identified twenty zip codes that are characterized by Warren Communications' database of local cable television systems as not having access to cable television service but are allegedly wired for cable television. Professor Willig's critique of the Warren data is flawed for at least two reasons.

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48. *See, e.g,* David Lieberman, *Combining Systems Could Inconvenience Consumers*, USA TODAY, Oct. 30, 2001 (questioning whether "chains such as Best Buy, Circuit City, Radio Shack or Blockbuster will have much incentive to promote EchoStar's service, which will use the DIRECTV brand").

49. *Ergen's Statement, supra* note 43.

50. *Willig Reply Declaration, supra* note 3, ¶ 102.

42. First, the Warren data present census block groups—not zip codes—that are wired for cable television. Because a zip code is larger than a census block group, it is possible that certain census blocks contained within the twenty zip codes do not have access to cable television service while other census blocks within the same zip codes do have access. The fact that there are individuals with access to cable television service in the same zip code that contains a census block that the Warren data indicates to be unpassed by cable is not sufficient to demonstrate that the Warren data are flawed.

43. Second, Professor Willig does not disclose how many Warren zip codes the research firm tested. For example, if the research firm tested 200 zip codes, and if it found that Warren was wrong on twenty occasions (10 percent of the time), then the inference that one would make on the reliability of the Warren data would be different from the inference that one would make if the research firm tested 20,000 zip codes (errors occurring 0.1 percent of the time). Professor Willig does not supply that critical information.

44. Finally, it is reasonable to believe that a company with the resources of EchoStar or DIRECTV could detect, with a reasonable degree of accuracy, whether its customers have access to cable television service. For example, the DBS firm could simply ask the customer whether he or she had access to cable television service before the sale of DBS service. More likely, each DBS firm has developed over the years a thorough database of geographic areas with and without access to cable television service. In fact, DIRECTV recently informed the FCC that 29 percent of its customers did not have access to cable service.[51]

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[51] Comments of DirecTV, Inc., Annual Assessment of the Status of Competition in the Markets for the Delivery of Video Programming, CS Dkt. No. 01-129 (filed Aug. 3, 2001).

45. Setting aside the questionable issue of detection, a very simple means by which the merged DBS firm could discriminate against customers without access to cable television service would be to offer rebates to customers who mail in their cable television bills. Under this discriminatory scheme, customers without access to cable television service would be forced to pay the higher (standard) price, while customers with access to cable television service would be entitled to the discount. Indeed, both DIRECTV and EchoStar have implemented such pricing schemes in the past.[52]

c. The Merged Firm Could Reduce the Number of Channels for Customers in Areas without Cable Television Service

46. As another strategy of geographic discrimination, the merged DBS firm could use spot beams to target certain national channels exclusively at larger DMAs. That is, the merged DBS firm could withhold select national content from smaller DMAs. The merged DBS firm could claim that certain channels fare much better with urban market demographics, and it could then broadcast those channels exclusively to non-rural residents. If the merged DBS firm were required to carry the same number of channels in all areas, it could target more expensive channels at non-rural DMAs and cheaper "filler" stations to rural DMAs—all ostensibly in the name of better serving the consumer. Although the merged DBS firm would continue to charge a single national price for its programming packages, the quality of (and cost per subscriber for) the packages could vary on a local basis.

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52. On February 23, 1998, DIRECTV launched an advertising campaign urging cable customers to switch to DIRECTV. *See DIRECTV Capitalizes on Cable Complaints*, ADVERTISING AGE, Feb. 23, 1998, at *1. Shortly thereafter, EchoStar offered free programming to cable customers who turned in their cable bills.*See Dish Network Announces Unbeatable Deal*, BUS. WIRE, Mar. 11, 1998.

47. One way of differentiating between urban and rural markets is suggested by DIRECTV's current course of conduct with YES, the new New York Yankee network. YES is available as part of DIRECTV's Total Choices® monthly service to customers in and around New York City, but it is available elsewhere only to subscribers to the DIRECTV SPORTS PACK, a completely different package, with its own pricing.[53]

48. Alternatively, the merged DBS firm could adopt a plan of continuously "test marketing" new channels in the larger DMAs. For example, the merged DBS firm could offer a new sports channel free-of-charge to select DMAs for a limited time. Then, upon expiration of the trial period, the firm could immediately offer a new movie channel to the same DMAs for a limited period of time. By targeting those new offerings at DMAs in which the monopoly DBS provider faced particular competitive challenges from cable television system operators, the merged firm could effectively respond to local MVPD competition by augmenting the value of its service in only those areas. A uniform national pricing plan would not force the merged firm to respond to local competition at the national level. The DBS monopoly would by no means be forced to "export" the benefits of urban competition to rural consumers.

d. The Merged DBS Firm Could Vary the Price of Local Broadcast Channels

49. Because local broadcast channels are offered only in their originating DMAs, they are not a part of the national DBS programming package. Hence, the merged DBS firm could satisfy a uniform national pricing pledge simply by charging a single national price for each *non-local* programming package. The merged DBS firm would, however, be free to charge different

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[53] DIRECTV, *YES Network and DIRECTV Announce Network's First Distribution Agreement*, Company Press Release, Feb. 5, 2002 (downloaded from

prices for different local broadcast packages. For example, the merged firm could charge $3.99 per month for local broadcast channels in Los Angeles, California, and $5.99 per month for local broadcast channels in Billings, Montana. Local broadcast channel offerings differ considerably from region to region, so the merged DBS firm could claim that such varied prices merely reflect the differing demand characteristics (and costs) of each local service package. In the absence of cost-based regulation of DBS prices, which no one is proposing that the FCC impose, there would be no way to confirm that the price-cost ratio for local broadcast programming was the same across all geographic markets in which the merged DBS firm offered local broadcast channels.

B. Even If the Merged DBS Firm Did Not Discriminate Against Rural Customers, DBS Consumers in Urban Areas Would Face Higher Prices

50. A uniform national pricing plan would be anticompetitive. It would raise DBS prices for all urban customers and would facilitate collusion between the cable television system operator and the remaining DBS firm. Professor Willig does not remove the basis for either concern.

1. The Post-Merger Uniform Price Would Exceed the Pre-Merger Discriminatory Price in Areas with Cable Television Service and Would Likely Exceed the Pre-Merger Discriminatory Price in Areas without Cable Television Service

51. Professor Willig argues that monopoly rural markets would be protected after the proposed merger by a uniform national price, which he claims would be most affected by conditions in more populous urban markets, where most potential customers reside. However, Professor Willig does not dispute that the post-merger nationwide price would exceed the pre-

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<http://www.directv.com/DTVAPP/aboutus/headline.jsp?id=02_05_2002A> on Apr. 16, 2002).

merger price in urban areas. There are two reasons for this outcome. First, in urban areas the proposed merger would reduce the number of competitors from 3 to 2, making an already concentrated market into an extremely concentrated market, with a strong likelihood that prices would be higher than the pre-merger level. Second, a post-merger uniform national price that is lower than the unconstrained rural price must be supported by prices higher than the unconstrained price in urban areas that would obtain under a regime of differential pricing. Instead of confronting that issue, Professor Willig conjectures that the post-merger price in rural areas would be the same as the post-merger price in urban areas:

> As noted above, larger DMAs appear to be more competitive than smaller DMAs. For example, larger DMAs are more likely to have digital cable systems which are a more formidable competitor to DBS, since they eliminate DBS' quality and channel capacity advantages. Therefore, New EchoStar's national price will allow smaller, more rural DMAs to benefit from the more intense competition in larger DMAs.[54]

Professor Willig fails to answer my demonstration that, after the proposed merger, urban customers would face higher DBS prices (and a greater price increase than that to be expected simply from the reduction in the number of competitors from 3 to 2).

52. As I explained in greater detail in my initial declaration,[55] to set the uniform national price, the profit-maximizing DBS firm would raise the duopoly price to the point where the gains from rural consumers (gains from inframarginal consumers minus losses from marginal consumers) would equal the losses from urban consumers (gains from inframarginal consumers minus losses from marginal consumers). The resulting uniform price would be lower than the discriminatory post-merger rural monopoly price and higher than the post-merger discriminatory urban duopoly price. Because the uniform price would be imposed under *less* competition in the

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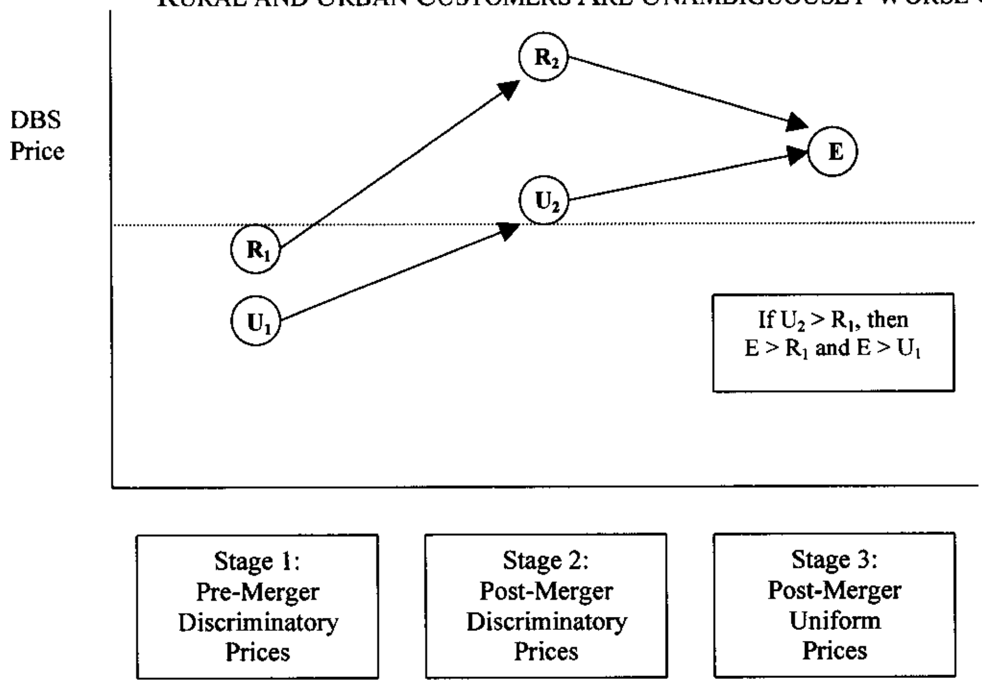
54. *Willig Reply Declaration*, *supra* note 3, ¶ 46.

two representative geographic markets, it is easier to analyze the effect of the uniform pricing pledge by disaggregating the price increase into three stages. Figure 2 shows how the merged firm would choose a uniform post-merger DBS price beginning from discriminatory pre-merger prices.

FIGURE 2: THREE STAGES OF THE POST-MERGER DBS PRICE INCREASE: RURAL AND URBAN CUSTOMERS ARE UNAMBIGUOUSLY WORSE OFF



R_1 = Stage 1 Rural Price; U_1 = Stage 1 Urban Price; R_2 = Stage 2 Rural Price, U_2 = Stage 2 Urban Price, E = Stage 3 Uniform Price

As Figure 2 shows, the post-merger discriminatory prices in both rural and urban areas are higher than the respective pre-merger discriminatory prices (R_2 is greater than R_1 and U_2 is greater than U_1). Indeed, the price increase in rural areas is greater (the line R_1- R_2 is steeper than the line U_1-U_2) because demand for DBS service in rural areas is less price elastic. The post-merger uniform price is a weighted average of the post-merger discriminatory prices in areas with and without cable television service. As Figure 2 shows, if the post-merger price in urban areas exceeds the

55. *Sidak Declaration*, *supra* note 1, at 31 ¶¶ 54-56.

pre-merger price in rural areas—that is, if U_2 is greater than R_1—then one can infer *unambiguously* that both rural and urban customers of DBS service are worse off under the post-merger uniform national price.[56]

2. The National Price Would Facilitate Collusion with Cable Television System Operators

53. Professor Willig believes that the nature of competition between the DBS carriers and cable television system operators will remain unchanged if the proposed merger is approved:

> The proposed merger between DIRECTV and EchoStar . . . will eliminate spectrum redundancies and allow for expanded channel capacity—which will likely spur the development of new programming and new innovative services. Such an expansion of channel capacity will likely force cable systems to continue to upgrade their network infrastructure. Relative to today's cable infrastructure, an upgraded cable system will exert even more competitive pressure on DBS pricing—thus perpetuating the virtuous cycle of competitive innovation.[57]

Professor Willig is incorrect. Cable television operators have upgraded their systems *in response to* the serious challenges posed by DIRECTV and EchoStar. If that competition were undermined by industry consolidation, then cable television operators would be relieved from the competitive pressure to innovate. Professor Willig fails to note that elimination of the second DBS firm would likely induce exit by suppliers of innovative content and next-generation set-top boxes, which would harm the "virtuous cycle of competitive innovation" that he extols. The proposed merger would make the competition between the merged DBS firm and cable television operators less robust.

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56. The only scenario where the change in welfare for rural customers of DBS services is ambiguous is if the post-merger discriminatory price in urban areas is less than the pre-merger discriminatory price in rural areas. Under such a scenario, it is impossible to say with certainty on the basis of a priori reasoning whether the uniform pricing pledge will restore the welfare of rural customers. The question is an empirical one for which EchoStar and DirecTV bear the burden of proof. Nonetheless, the change in welfare for urban customers under a post-merger uniform pricing regime is adverse under *any* scenario. Professor Willig has yet to dispute my demonstration that, even if the merged DBS firm were to abide by its pledge to price in a nondiscriminatory manner, DBS customers in urban areas would pay higher prices.

54. Moreover, Professor Willig too quickly dismisses the likelihood that the merged DBS firm would coordinate prices with the local cable television operator:

> Although New EchoStar will face competition from at least one cable firm in any particular franchise area, tacitly reaching an agreement on a coordinated price is not simply a question of reaching an agreement with one other firm. New EchoStar will set its price based on a function of what cable firms are charging in the various franchise areas. From the perspective of the cable firms, the optimal price for New EchoStar to charge would likely differ from firm to firm, making an agreement all the more difficult to reach.[58]

Professor Willig ignores that a handful of cable television multiple systems operators (MSOs) now control a significant majority of all cable properties. As of June 2001, the top four MSOs—AT&T-Comcast (assuming that the proposed merger is approved), AOLTime Warner, Charter, and Cox—served 70 percent of all cable television customers.[59] Hence, price coordination between AT&T, for example, and the merged DBS firm could occur in the hundreds of local cable television systems controlled by AT&T. Contrary to Professor Willig's assertions, the merged DBS firm would *not* need to reach hundreds of distinct arrangements with each local cable television system operator owned by AT&T, AOL-Time Warner, Comcast, and the other large MSOs.

CONCLUSION

55. Professor Willig has failed to produce any relevant analysis to rebut the presumption of anticompetitive effects that is made in the case of a merger to monopoly or near monopoly, much less answer the arguments as to anticompetitive effects made in my initial declaration. Moreover, Professor Willig has failed to document the merger-specific efficiencies

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57. *Willig Reply Declaration, supra* note 3, ¶ 49.
58. *Id.* ¶ 72.

that he claims would flow from this merger-to-monopoly. Professor Willig's two declarations in this proceeding do not contain the evidence that would be necessary for EchoStar and DIRECTV to carry their burden of proof on either issue. Professor Willig supplies no information of probative value to support his assertion that the merged DBS firm could lower its programming cost by taking advantage of volume discounts. Nor does he supply any evidence to support the claim that the unknown incremental consumer surplus associated with additional programming or enhanced services would compensate for the enormous consumer welfare losses that my initial declaration and Professor MacAvoy's initial declaration demonstrated would result from higher DBS prices following the proposed merger. Professor Willig's reply declaration does not alter the conclusion that the Commission can protect consumer welfare in this proceeding only by rejecting the proposed merger of DIRECTV and EchoStar.

* * *

I declare under penalty of perjury that this declaration is true and correct. Executed this 24th day of April, 2002.

J. Gregory Sidak

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59. *Eighth Annual Report*, *supra* note 26, at Table C-3.