

COMMUNICATIONS LAW UPDATE

October 7, 2005

Intelsat and PanAmSat Agree to Merge

On August 29, 2005, Intelsat, Ltd. (Intelsat), the second largest commercial satellite company (in revenues), announced that it would acquire PanAmSat Holding Corporation (PanAmSat), the third largest, for \$25 per share in cash, or \$3.2 billion. The merger, if approved by regulators, would result in a combined fleet of 53 satellites serving customers in more than 220 countries and territories.¹ It would be another major step toward consolidation in an industry recently challenged by overcapacity problems and intermodal competition from transoceanic cable companies. The merger also would bring an ironic end to the longstanding (if recently diminished) rivalry between Intelsat, the one-time government-owned monopoly provider of international satellite services, and its upstart, privately owned competitor PanAmSat.

Terrestrial Relays. Seeking better technological options for international phone and television service, Clarke observed that a "space station" placed a certain distance above the Earth would have an orbital frequency of 24 hours, and, therefore, would constantly be situated over the same point of the terrestrial globe. With appropriate equipment, such a station "could act as a repeater to relay transmissions between any two points on the hemisphere beneath, using any frequency which will penetrate the ionosphere."²

Sixteen years later, President John F. Kennedy called on the United States to lead an international effort to develop and operate the world's first global satellite communications system. The United Nations soon followed with a resolution similarly supporting establishment of a satellite system for all nations. Eleven countries (including the United States) responded in 1964 by creating the International Telecommunications Satellite Consortium (INTELSAT), in which they agreed to participate through public or private telecommunications entities known as "signatories." In 1965, INTELSAT launched its first satellite, Early Bird (INTELSAT series I).³

The Origins of the Commercial Satellite Industry

Today's extensive network of geostationary satellites, providing coverage literally to the ends of the earth, had its origins in the seminal 1945 article by British physicist and science fiction writer Arthur C. Clarke, *Extra-*

1. Press Release, Intelsat and PanAmSat to Merge, Creating World-Class Communication Solutions Provider, Aug. 29, 2005, available at http://www.intelsat.com/press/release_details.aspx?year=2005&art=20050829_01_EN.xml&lang=en&footer=7 ("Press Release").

2. Arthur C. Clarke, *Extra Terrestrial Relays*, *Wireless World*, Oct. 1945, at 306, available at <http://www.sciencemuseum.org.uk/on-line/clarke/ww3.asp>.

3. See *Making History*, available at <http://www.intelsat.com/aboutus/ourhistory/yr1960s.aspx>; Charles H. Kennedy & M. Veronica Pastor, *An Introduction to International Telecommunications Law* 65-67, 74 (1996); Kenneth Katkin, *Cable Open Access and Direct Access to INTELSAT*, 53 Case W. Res. L. Rev. 77, 87-91 (2002).

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In 1988, PanAmSat launched the PAS-I Atlantic Ocean Region satellite, the first US private-sector satellite to provide international satellite services.

INTELSAT was founded on the premise that international satellite telecommunications are a quintessential natural government monopoly—in part because they have high fixed costs compared to low marginal costs of providing service once a facility has been built.⁴ The founding agreements allowed INTELSAT to authorize other satellite systems, but only if the proponent demonstrated that the new entrant would cause no technical or economic harm to INTELSAT. Until 1985, US regulators did not allow separate satellite systems to provide international communications services to or from the United States. The United States signatory to INTELSAT was the government-created, privately owned corporation known as COMSAT, which enjoyed the exclusive right to provide INTELSAT transmission capacity in the United States.

In 1979, in a parallel development, a group of nations and signatories formed the International Maritime Satellite Organization (Inmarsat)—modeled on INTELSAT—to develop and operate a global maritime satellite telecommunications system. COMSAT similarly enjoyed an exclusive franchise to provide Inmarsat transmission capacity for communications between ships on the ocean and the United States.

Competition Emerges

The natural monopoly model for international satellite communications lost favor in the United States in the 1980s, just as it lost favor in other areas of telecommunications. In 1984, Rene Anselmo founded PanAmSat and launched the world's first privately owned

international satellite.⁵ In 1985, the Federal Communications Commission (FCC) granted PanAmSat and other companies authority to establish international satellite systems separate from INTELSAT, after the Reagan administration declared that they were required in the national interest.⁶ In 1988, PanAmSat launched the PAS-I Atlantic Ocean Region satellite, the first US private-sector satellite to provide international satellite services.⁷

To ensure that separate operators did not harm INTELSAT economically, the FCC at first imposed restrictions, including, among others, a prohibition on separate systems' interconnection with the public switched telephone network. But challenges by new entrants chipped away at these limits. In 1990, PanAmSat (opposed by COMSAT) urged the FCC to dismantle them further, prompting yet another extensive review of the industry by the Executive Branch. In 1992, heeding the Executive Branch's recommendations, the FCC authorized separate satellite systems to offer international private-line circuits interconnected to the public switched network, and ordered all restrictions on interconnection to be eliminated by 1997.⁸

The rest of the decade witnessed steadily increasing satellite competition. Soon after its acquisition by Hughes Electronics Corporation in 1996, PanAmSat could boast a fleet of 14 satellites.⁹ By 1999, of the over 200 commercial geosynchronous satellites that orbited the earth, only 17 belonged to INTELSAT. Also, INTELSAT owned just 13 of the 73 serving the United States.¹⁰

4. See Kennedy & Pastor, *supra* note 3 at 79; Katkin, *supra* note 3 at 84-85.

5. See Brief History of PanAmSat, *available at* <http://www.panamsat.com/company/timeline.asp>.

6. See Report and Order, *Establishment of Satellite Systems Providing International Communications*, 101 F.C.C. 2d 1046 ¶¶ 1, 5 (1985); Kennedy & Pastor, *supra* note 3 at 88; Katkin, *supra* note 3 at 101-02.

7. See Brief History of PanAmSat, *available at* <http://www.panamsat.com/company/timeline.asp>; Katkin, *supra* note 3 at 101-102.

8. Order, *Permissible Services of US Licensed International Communications Satellite Systems Separate From the International Telecommunications Satellite Organization (Intelsat)*, 7 FCC Rcd 2313 ¶¶ 5-6 (1992); Kennedy & Pastor, *supra* note 3 at 89-90.

9. Brief History of PanAmSat, *available at* <http://www.panamsat.com/company/timeline.asp>.

10. See Katkin, *supra* note 3 at 101-02.

Meanwhile, the entire satellite industry, including INTELSAT, had to contend with intermodal competition. In 1988, as PanAmSat launched the PAS-I, AT&T Corp. completed the world's first transoceanic fiber-optic cable, the TAT-8, which ran 3,000 miles from New Jersey to Great Britain and offered capacity comparable to that offered by satellites. The first trans-Pacific fiber-optic cable entered service in 1991.¹¹ By 1999, submarine fiber optic cables provided about three times the number of US international transmission circuits delivered by all satellites—including INTELSAT's—combined.¹²

Non-geostationary satellites—those positioned in lower-earth and middle-earth orbit systems—provide additional competition, but focus on mobile satellite services (as Inmarsat does) rather than the fixed services targeted by INTELSAT. Moreover, the leading ventures—Iridium, Globalstar, and ICO—by 2000 found themselves in bankruptcy or other financial difficulty, due in large part to the ubiquity of terrestrial wireless. Those companies have re-emerged, serving narrower markets and migrating toward geostationary satellites themselves. Their services saw heavy use in areas hit by natural disasters such as the recent Gulf Coast hurricanes.

Privatization and Consolidation

With competition flourishing in international communications, the rationale for INTELSAT's status as an intergovernmental organization dissolved. In March 2000, Congress enacted the comprehensive Open-Market

Reorganization for the Betterment of International Telecommunications Act (ORBIT Act),¹³ requiring pro-competitive privatizations of INTELSAT and its maritime clone Inmarsat. The United States, of course, could not unilaterally transform these treaty-based organizations. But the ORBIT Act provided strong incentives, by prohibiting INTELSAT and Inmarsat from providing new US services until they privatized in accordance with the Act. The ORBIT Act also removed prior statutory ownership requirements for COMSAT, allowing Lockheed Martin to buy control of the company.

The privatizations succeeded. INTELSAT, which had grown to 144 member governments, converted to the Bermuda-based stock corporation Intelsat, Ltd., which was subsequently acquired by a private equity group.¹⁴ The FCC then found that Intelsat had complied with all of the privatization criteria set forth in the ORBIT Act (as amended).¹⁵

Other private equity deals also have rippled through the industry, harbingering consolidation. In 2003 and 2004, investment firms or groups acquired Inmarsat, PanAmSat, and New Skies, a Dutch operator created by the spinoff of certain Intelsat assets. Moreover, Intelsat in 2004 acquired a large portion of Loral's domestic satellite fleet and related customer contracts, providing entry into the North American video and corporate data markets. Shortly before announcing its planned purchase of PanAmSat, Intelsat was rumored to be negotiating for the purchase of New Skies, further reflecting analyst sentiment “that the [fixed satellite service] industry has the potential for

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11. See *id.* at 102-03.

12. See *id.* at 130-31.

13. Open-Market Reorganization for the Betterment of International Telecommunications Act, Pub. L. No. 106-180 § 641(a), 114 Stat. 48, 55 (2000).

14. See Our History 2000 And Beyond, available at <http://www.intelsat.com/aboutus/ourhistory/yr2000s.aspx>; Memorandum Opinion and Order, *Petition for Declaratory Ruling that Intelsat, Ltd. Complies With Section 621(5)(F) of the ORBIT Act*, 20 FCC Rcd 8604 ¶ 7 (2005) (“April 2005 Intelsat Order”); Katkin, *supra* note 3 at 90-91 & n.56.

15. *April 2005 Intelsat Order* ¶ 14.

consolidation”¹⁶ PanAmSat, having been bought in 2004 by a consortium of private equity firms led by Kohlberg Kravis & Roberts, went public earlier in 2005.

Prospects for the Merger

The proposed Intelsat-PanAmSat merger is subject to Hart-Scott-Rodino review (likely by the US Department of Justice), FCC approval of the necessary license transfers, and possibly review by the European Commission. If approved, the merger would leave at least two other large industry players, namely SES Global and Eutelsat, and numerous smaller national and/or regional operators such as New Skies and Loral Skynet. According to an early Citigroup analyst report, smaller operators outside the “top four” (SES, Intelsat, PanAmSat and Eutelsat) presently have a combined market share (measured in revenues) of almost 36 percent.¹⁷ The merger reportedly would give the combined company the same number of satellites over the United States as SES, but more overall capacity.¹⁸

Analysts’ views about whether the merger will go forward are mixed. Citigroup opined that it was “highly unlikely” that European or US regulators would allow the deal to go through based on potential antitrust concerns.¹⁹ In support of this view, Citigroup noted elevated Herfindahl-Hirschman indices (HHI) for the Government and Network

segments of the Fixed Satellite Service industry post-merger.²⁰ That same report, however, acknowledged that it was unclear how regulators would define the relevant markets to be examined.

Intelsat and PanAmSat officials, meanwhile, maintain that the deal should not raise antitrust concerns because the firms’ respective businesses and clients are “complementary”: Intelsat focuses on core telephony and advanced data services while PanAmSat has built a strong, video-centric business.²¹ Company officials also emphasize increasing intermodal competition from terrestrial sources.²² That said, the merger agreement requires consummation of the deal so long as Intelsat is not required to divest more than three revenue-producing IA series satellites (purchased from Loral). But analysts remain skeptical that even this limited divestiture should be required, because it would only weaken the combined company against SES, a vigorous video competitor.²³ And according to a White Paper by the Futron consulting company, notwithstanding the merger, in some areas “the large number of ‘independent’ operators” would “maintain[] a competitive environment,” thereby “demonstrat[ing] that there is still room for further consolidation on either a regional or global basis, without the satellite industry being reduced to a monopoly or even a duopoly.”²⁴

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If you have any questions or need additional information, please contact:

William T. Lake

202 663 6725

william.lake@wilmerhale.com

John H. Harwood II

202 663 6333

john.harwood@wilmerhale.com

David S. Mendel

202 663 6128

david.mendel@wilmerhale.com

16. *Orbiting Wall Street*, Mobile Satellite News, Aug. 22, 2005 (quoting Vijay Jayant, Lehman Brothers Research Report, Aug. 19, 2005).

17. Jason Bazinet, et al., *Citigroup Small/Mid-Cap Research: PanAmSat Holding Corp (PA)*, Aug. 30, 2005 (“Citigroup Report”).

18. *Intelsat/PanAmSat Deal Would Go Through Minus 3 IA Satellites*, Communications Daily (Sept. 6, 2005).

19. Citigroup Report at 2.

20. *Id.* at 2-3.

21. See Press Release, *supra* note 1.

22. *Intelsat, PanAmSat Announce Intent to Merge*, Communications Daily (Aug. 30, 2005).

23. *Intelsat/PanAmSat Deal Would Go Through Minus 3 IA Satellites*, Communications Daily (Sept. 6, 2005).

24. *What’s Up With Satellite Consolidation*, Futron White Paper, Sept. 2005, available at <http://www.futron.com/pdf/SatelliteConsolidation.pdf>.