The American
Antitrust Institute

June 5, 2007

By Electronic Submission
Ms. Marlene H. Dortch, Secretary
Federal Communications Commission
445 12th St., S.W.
Washington, D.C. 20554

Re: MB Docket No. 07-57

Dear Ms. Dortch:

Enclosed please find for filing, Comments of the American Antitrust Institute ("AAI") in Opposition to the Consolidated Application for Authority to Transfer Control of XM Radio Inc. and Sirius Satellite Radio Inc. AAI is an independent non-profit education, research, and advocacy organization. Its mission is to advance the role of competition in the economy, protect consumers, and sustain the vitality of the antitrust laws.

As set forth in the Comments, AAI believes that the Commission should address the merits of repealing the Commission's rule forbidding a single satellite DARS licensee from acquiring control of the other licensee in a rulemaking proceeding *before* the Commission considers the transfer application.

With respect to the rule, the Applicants have not demonstrated that competition in satellite DARS is no longer in the public interest. On the contrary, competition between the Applicants has provided, and will continue to provide, significant benefits to consumers, whereas the public interest benefits of the merger are dubious. As long as the firms are likely to be viable without the merger, and satellite radio is not a natural monopoly, there is no good reason for the Commission to abandon its policy of ensuring competition in the delivery of spectrum-based services in satellite DARS.

Very truly yours,

Richard M. Brunell
Director of Legal Advocacy

cc: The Hon. Kevin J. Martin
The Hon. Michael J. Copps
The Hon. Jonathan S. Adelstein
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
XM Satellite Radio Holdings Inc., Transferor	)	
and	)	MB Docket No. 07-57
Sirius Satellite Radio Inc., Transferee	)	
Consolidated Application for Authority to Transfer Control of XM Radio Inc. and Sirius Satellite Radio Inc.	)	

COMMENTS OF THE AMERICAN ANTITRUST INSTITUTE IN OPPOSITION TO TRANSFER APPLICATION

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Introduction and Summary

The American Antitrust Institute ("AAI")[1] submits these comments in opposition to the Consolidated Application ("Application") for Authority to Transfer Control of XM Radio Inc. ("XM") and Sirius Satellite Radio Inc. ("Sirius"). Based on the submission of the Applicants and publicly available information, AAI has concluded that the Applicants have not met their heavy burden of demonstrating that the proposed merger is in the public interest. In particular, they have not demonstrated that the rationale for the Commission's 1997 rule forbidding a monopoly in the Satellite Digital Audio Service (DARS) has been undermined by subsequent developments.

The Commission's DARS anti-monopoly rule was premised on the policy that intramodal competition in spectrum-based services is desirable if it is feasible. Such competition tends to lead to lower prices, higher quality, and greater innovation and efficiency, albeit at the cost of a duplicative infrastructure and some overlap in programming. The Applicants do not claim that competition in DARS has been a failure; on the contrary, competition between the two providers has provided significant consumer benefits. They do not claim that competition in DARS is no longer feasible or that DARS is a natural monopoly; on the contrary, they contend that they will survive and prosper regardless of whether they merge. In these circumstances, it is far too early in the

[1] AAI is an independent non-profit education, research, and advocacy organization. Its mission is to advance the role of competition in the economy, protect consumers, and sustain the vitality of the antitrust laws. AAI is supported by voluntary donations into its general treasury and has no financial interest in this matter. The Advisory Board of AAI, which serves in a consultative capacity, consists of prominent antitrust lawyers, law professors, economists, and business leaders. *See* http://www.antitrustinstitute.org. AAI is managed by its Board of Directors, which has approved of this filing. The individual views of members of the Advisory Board may differ from the positions taken by AAI, and members of the Advisory Board with any interests in this matter were not involved in the development or preparation of these comments. AAI has frequently commented on pending mergers, including mergers that have been before the Commission.

life of this industry to abandon intramodal competition in exchange for the weak public interest benefits proffered by the Applicants. Those benefits do not appear to be merger specific or likely to increase the merged company's incentives to lower prices, improve quality, enhance services or offer new products. Indeed, the principal benefit proposed by the Applicants – to allow consumers to access the best programming from both services using a single receiver – should have been already available to consumers if the Applicants had fully complied with the Commission's interoperable-receiver mandate.

Conventional merger analysis indicates that the merger poses a significant risk of anticompetitive effects, including higher prices, reduced quality, and reduced consumer choice. The available evidence tends to suggest that satellite radio is a relevant antitrust market and that the potential substitutes (such as terrestrial radio, HD radio, iPods, cell phones and Internet radio) are not now, nor are they likely in the near future to be, sufficient to replace the significant competitive constraint that each firm currently places on the other. A rate freeze or other regulatory "solution" to the loss of competition from the merger would be inadequate, undesirable, and inconsistent with the deregulatory policy of the Commission and the Telecommunication Act of 1996. For these reasons, as more fully explained below, the transfer application should be denied.

I. The Applicants Bear a Heavy Burden to Demonstrate that Eliminating Competition in the Satellite Digital Audio Radio Service Is in the Public Interest.

In this matter, the Applicants do not merely have the burden of proving by a preponderance of the evidence that the proposed transaction, on balance, serves the public interest. They also have the burden of persuading the Commission to repeal its rule barring a single firm from controlling the two licenses for the Satellite Digital Audio Radio Service (DARS)[2] and to abandon its "long-standing policy of promoting competition in the delivery of spectrum-based communications services" (intramodal competition).[3] Only a compelling justification could warrant the creation of a monopoly in the provision of spectrum-based services,[4] which would be unprecedented.[5] However, the Applicants have not convincingly demonstrated that it would be in the public interest

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[2] The Commission's order establishing the DARS service provided that with respect to transfers of DARS licenses:

> We note that DARS licensees, like other satellite licensees, will be subject to rule 25.118, which prohibits transfers or assignments of licenses except upon application to the Commission and upon a finding by the Commission that the public interest would be served thereby. Even after DARS licenses are granted, one licensee will not be permitted to acquire control of the other remaining satellite DARS license. This prohibition on transfer of control will help assure sufficient continuing competition in the provision of satellite DARS service.

Establishment of Rules and Policies for the Digital Audio Radio Satellite Service in the 2310-2360 MHz Frequency Band, 12 FCC Rcd 5754, 5823, ¶ 170 (1997) ("*DARS Report and Order*").

[3] *Application of EchoStar Communications Corp., et al.*, 17 FCC Rcd 20559, 20598, ¶ 88 (2002) ("*EchoStar/DirecTV Order*").

[4] *See id.* at 20603, ¶ 96 ("Applicants have presented no compelling reason, from a spectrum policy standpoint, why we should approve license transfers that would effectively replace facilities-based intramodal DBS service competition with a monopoly on full-CONUS DBS licenses."); *An Inquiry Into the Use of the Bands 825-845 MHz and 870-890 MHz for Cellular Communications Systems; and Amendment of Parts 2 and 22 of the Commission's Rules Relative to Cellular Communications Systems*, 86 F.C.C. 2d 469, 478 (1981) ("[E]ven the introduction of a marginal amount of facilities-based competition into the cellular market will foster important public benefits of diversity of technology, service and price, which should not be sacrificed absent some compelling reason.").

[5] *See infra.* note 17.

for the Commission to repeal its DARS anti-monopoly rule and eliminate intramodal competition in satellite radio.[6]

In 1997, when the FCC established DARS service with two licenses and provided that those licenses could not be acquired by a single company, it did so in order to ensure intramodal competition in DARS, notwithstanding the competition provided by terrestrial radio and other sources of aural entertainment. The Commission stated its goal was "*to create as competitive a market structure as possible*, *while permitting each DARS provider to offer sufficient channels for a viable service*", which at that time was assumed to be 19 to 44 channels.[7]

Originally, the Commission had proposed that four licenses be awarded 12.5 MHz of spectrum, but was precluded from doing so when Congress allotted half of the

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[6] The Applicants argue that the bar against the combination of the two licenses is not a rule, but merely a policy statement, since it was not codified in the Code of Federal Regulations. Application at 50. However, codification is not a *sine qua non* for a binding rule. *See Community Nutrition Institute v. Young*, 818 F.2d 943, 947 & n.8 (D.C. Cir. 1987). They also maintain that that the Commission may "waive" (i.e., repeal) the rule in the context of an adjudicatory proceeding with proper notice. *Id.* at 51. However, given the lack of exigent circumstances and the competitive costs associated with a pending merger such as this, a strong case exists for requiring the Applicants to obtain a change in the rule via a rulemaking proceeding *before* they file a transfer application that is squarely barred by the rule. During the pendency of a merger, competition between merging parties is often reduced because of the natural tendency of the parties to pull their competitive punches and the standard contractual requirements to avoid material changes in the businesses. *See generally* William Blumenthal, *The Scope of Permissible Coordination Between Merging Entities Prior to Consummation*, 63 ANTITRUST L.J. 1, 19 (1994) (noting that merging firms regularly will engage in unilateral action that is different from what it would have been had the transaction not been pending); *id.* at 24 ("Numerous interim covenants in merger agreements (such as limitations on new capital and material new contracts) would be summarily condemned if nakedly executed by competitors . . . ."). Thus, for example, it is unlikely that XM or Sirius will enter into significant new programming deals, adopt a la carte pricing, or introduce an interoperable radio while the merger is pending. Ordinarily, the natural diminution in competition associated with pending mergers is tolerated in light of the practical difficulties of evaluating merely potential transactions and the reality that most mergers are likely to be approved. However, where, as here, the Commission has adopted a prophylactic rule that bars the merger, the public should not bear the risk of diminished competition in connection with a pending merger. Accordingly, the Commission should insist that the Applicants obtain a change in the rule in a rulemaking proceeding before the Commission will consider their transfer application.

[7] *DARS Report and Order*, 12 FCC Rcd at 5786, ¶ 77 (emphasis added).

spectrum planned for DARS to other uses. The Commission explained, "Although spectrum constraints limit us to licensing just two satellite DARS systems at this time, our licensing approach nonetheless provides the opportunity for a competitive DARS service."[8] While "competition from terrestrial radio services, CD players in automobiles and homes, and audio services delivered as a part of cable and satellite services" suggested that "fewer than four DARS providers[] could ensure an effectively competitive audio services market",[9] the Commission noted that "[o]ther audio delivery media are not … perfect substitutes for satellite DARS. These media and satellite DARS all differ with respect to the programming menu (terrestrial radio can provide local programming and satellite DARS cannot), the sound quality, the cost of equipment, and the presence or absence of a subscription fee . . . . The availability of these media, terrestrial radio in particular, varies across populated areas."[10] Accordingly, the Commission agreed with commenters (including Sirius) "that there should be more than one satellite DARS license awarded."[11] The Commissioned explained:

> Licensing at least two service providers will help ensure that subscription rates are competitive as well as provide for a diversity of programming voices. The two DARS licensees will compete against each other for satellite DARS customers and will face additional competitive pressure from the other aural delivery media mentioned above. Accordingly, eligible auction participants may acquire only one of the two licenses being auctioned.[12]

The Commission's policy of ensuring a modicum of intramodal competition was reiterated in its 2002 decision barring the merger of the two DBS licensees, DirecTV and EchoStar. The Commission noted its "long history of establishing spectrum-based

[8] *Id.*
[9] *Id.*
[10] *Id.* ¶ 78.
[11] *Id.*
[12] *Id.*

commercial services with no fewer than two participants per service, with the aim of creating competitive markets for spectrum-based voice, video and data services."[13] As an example of the policy, the Commission cited the DARS Order, noting that it "established a licensing approach that provided for two DARS licensees because it determined that more than one DARS licensee was necessary to ensure competitive rates, diversity of programming voices, and other benefits of a competitive DARS environment."[14] The Commission also cited its licensing of radio cellular service, PCS, CMRS service (as well as DBS) as examples of its policy of promoting intramodal competition.[15] The Commission has "consistently found that from the perspective of spectrum policy, the public interest is better served by the existence of a diversity of service providers wherever possible."[16] Indeed, the Applicants here, as in *EchoStar/DirecTV* "have cited no example where [the Commission has] permitted a single commercial spectrum licensee to hold the entire available spectrum allocated to a particular service."[17]

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[13] *EchoStar/DirecTV Order*, 17 FCC Rcd at 20662, ¶ 277.
[14] *Id.* at 20598, ¶ 88 (internal quotes omitted).
[15] The Commission stated:

> Similarly, in the initial provisioning of the radio cellular service, the Commission determined that the licensing of two systems for every cellular service area would best serve the public interest as it would foster important public benefits of diversity of technology, service and price, which should not be sacrificed absent some compelling reason. Consistent with this policy, the Commission determined that a competitive market was also the best way to introduce personal communication services ("PCS") to the public and adopted various measures to ensure that PCS licenses would be disseminated to a wide variety of applicants. Later, the Commission took actions to further its competitive policies by establishing a spectrum cap for CMRS. In doing so, the Commission found that such action would promote pro-competitive ends in the CMRS markets and discourage anticompetitive behavior while at the same time maintaining incentives for innovation and efficiency.

Id. (internal quotes omitted).
[16] *Id.* at 20603, ¶ 96.
[17] *Id* at 20662, ¶ 277.

Intramodal, facilities-based competition is not cost free. It entails duplication of facilities, which in the case of satellite radio runs into the billions of dollars. For entertainment programming, intramodal competition may also result in the duplicative use of spectrum, as each provider offers some programming that is similar if not identical to that offered by other providers. In some respects, a monopoly provider of spectrum-based services would be less "wasteful." But unless the spectrum-based service is a natural monopoly (and Applicants here do not claim that is the case in satellite radio), the Commission has correctly concluded that intramodal competition is the preferred option, because competition generally brings lower prices, greater diversity, more innovation, and greater efficiency.[18]

When the Commission made its decision to allocate the DARS spectrum to two licensees, it did not know whether satellite radio would be a successful product. Although it believed that satellite radio offered benefits that terrestrial radio could not offer (which was the main justification for its finding that the service provided public interest benefits), it did not know whether a single provider of DARS service would be able to exercise market power. Indeed, it predicted that after seven years of operation, the penetration rate for satellite DARS receivers in radio listening environments "may not be significantly greater than 4%" and that "satellite DARS' share of radio listening time

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[18] There is an additional benefit to intramodal competition that is not often discussed, namely that competition provides a competitive benchmark that enhances managerial efficiency. *See generally* JEAN TIROLE, THE THEORY OF INDUSTRIAL ORGANIZATION 75-76 (1988) (explaining that yardstick competition is more useful in industries with several competitors than in product market monopolies); Joseph Brodley, *Proof of Efficiencies in Mergers and Joint Ventures*, 64 ANTITRUST L.J. 575, 588 (1996) (maintaining that efficiencies do not justify merger to monopoly in part because "[i]n the absence of effective competition, even market participants lack a standard by which to judge business performance"). *See infra* note 80 discussing yardstick competition between XM and Sirius.

will grow relatively slowly over decades."[19] What it did know, however, was that competition in satellite DARS was preferred to a DARS monopoly as long as a competitive DARS was viable. The then-pending applicants claimed that competition in DARS *was* viable, and their bidding for the two licenses backed up their claims.

Ten years later, and only about five years after the launch of their services,[20] the Applicants still take the position that a competitive DARS is viable, and they will succeed with or without the merger.[21] However, they now claim that competition in DARS is not in the public interest. Having spent billions of dollars to create the infrastructure for competing DARS services, the Applicants now suggest that the whole experiment in competition was a mistake. Before the Commission abandons this experiment, it should demand strong evidence that intramodal competition in satellite radio does not benefit consumers.[22]

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[19] *DARS Report and Order*, 12 FCC Rcd at 5764-65, ¶¶ 20, 21. The actual penetration of satellite radio after only five years operation would seem to exceed the Commission's expectations. *See Sirius Satellite Radio at Credit Suisse Media & Telecom Week,* FD (FAIR DISCLOSURE) WIRE, Dec. 6, 2006 (Sirius CEO Mel Karmazin noting that penetration rate at the end of 2006 was about 11 or 12% of total households).

[20] The Applicants are still operating within the terms of their original eight-year licenses. *See* 47 C.F.R. § 25.144(d).

[21] Sirius CEO Mel Karmazin testified before Congress that if the merger is not permitted Sirius "will be a very healthy company. So this is not about survival. This is only about whether you believe the consumer is better off or not." Testimony of Mel Karmazin Before the Telecommunications and the Internet Subcommittee of the House Energy and Commerce Committee, *Hearing on The Digital Future of the United States: Part II, The Future of Radio*, March 7, 2007 ("Karmazin March 7, 2007 Congressional Testimony"); *see also Q4 and Full Year 2006 XM Satellite Radio Earnings Conf. Call -- Final*, FD (FAIR DISCLOSURE) WIRE, Feb. 26, 2007 (XM CEO Hugh Panero stated, "Should [the merger] prove impossible, we are well positioned to be a strong and enduring leader in the audio entertainment marketplace.").

[22] The Applicants have barely addressed the merits of the Commission's anti-monopoly rule, claiming that a "waiver" of the rule is appropriate because the "modern market for audio entertainment services in which satellite radio services competes for listeners has significantly evolved in the past ten years and is now extremely competitive." Application at 51-52. Thus, they assert that the rule "is no longer required to 'help assure sufficient continuing competition,' which was the purpose of the original restriction." *Id.* at 51 (quoting *DARS Report and Order* ¶ 170). This misses the point of the rule, which was not merely to assure competition in the audio

II. The Public Interest Benefits of the Merger Are Dubious.

Most, if not all, of the public-interest benefits claimed by the Applicants are jury-rigged, not merger specific, and do not increase the merged company's incentives to lower prices, improve quality, enhance services, or offer new products.

More programming choices at lower prices. The Applicants' principal argument for the merger is that it "will allow the combined company to offer consumers programming choices on a more a la carte basis at lower prices."[23] In addition to continuing to offer each of their existing packages of programming at the current $12.95 per month, the Applicants promise to offer packages of fewer channels at less than $12.95 (including a credit for blocked adult programming), and a "best of both" package of the companies' "prime" programming (such as MLB and NFL, Oprah and Martha Stewart) for a "modest premium over" $12.95 without consumers having to purchase a second receiver.[24] Putting aside the pricing issue, which is discussed *infra*, these benefits are not cognizable because they are not merger specific. The Applicants have not explained what prevents them from offering a la carte programming today. Nor is a merger necessary so that consumers may obtain the programming of both services without two receivers.

Interoperable receivers. In its rules establishing DARS, the Commission *required* the companies to develop an interoperable receiver, which would allow consumers to get

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entertainment market, but to assure "sufficient continuing competition *in the provision of satellite DARS service*." *DARS Report and Order*, 12 FCC Rcd at 5823, ¶ 170 (emphasis added).

[23] Application at 11.

[24] Before Congress Mr. Karmazin testified that the premium would range from $3 to $11. *See* Karmazin March 7, 2007 Congressional Testimony (discount off of $12.95 "looks closer to $10 than to $2"). In their application, the Applicants hedge their promise somewhat by noting, "Final decisions to make currently exclusive programming available on both services will be subject to contractual negotiations with programming partners." Application at 12 n.26.

both services without having to invest in two receivers and to switch easily between the two services.[25] Ten years later, there is still no interoperable receiver on the market. The Applicants claim that they have complied with the Commission's requirement and spent $25 million in a joint venture to develop an interoperable receiver,[26] but that "manufacturers have not expressed an interest in producing and distributing these radios, nor have any automobile manufacturers opted to include these radios in their vehicles."[27] The problem, according to the Applicants, is that they do not subsidize interoperable receivers, as they do other receivers, "because of uncertainty whether the subsidy would be recouped since the buyer might not subscribe to that company's service."[28] Assuming

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[25] The Commission provided that "satellite DARS licensees are required to design a receiver which would accommodate all satellite DARS providers. By promoting receiver inter-operability for satellite DARS, we are encouraging consumer investment in satellite DARS equipment and creating the economies of scale necessary to make satellite DARS receiving equipment affordable. This rule also will promote competition by reducing transaction costs and enhancing consumers' ability to switch between competing DARS providers." *DARS Report and Order*, 12 FCC Rcd at 5796, ¶ 103; *see also* 47 C.F.R. § 25.144(a)(3)(ii) (each applicant shall "[c]ertify that its satellite DARS system includes a receiver that will permit end users to access all licensed satellite DARS systems that are operational or under construction"). The Commission has reiterated this requirement on numerous occasions since authorizing the services. *See, e.g.*, *Sirius Satellite Radio Inc. [Application] for Minor Modification of License to Construct, Launch and Operate a Non-Geostationary Satellite Digital Audio Radio Service System*, 16 FCC Rcd 5419, 5428, ¶ 25 (Int'l Bur. 2001) ("requirement will permit consumers to purchase one receiver and be able to receive DARS from more than one provider"); *XM Radio Inc.; Application for Minor Modification to Relocate Satellite Digital Audio Radio Service (SDARS) Satellite*, 20 FCC Rcd 1620, 1625, ¶ 12 (Int'l Bur. 2005) (Sirius and XM required to "provide a clear timeframe for making … an interoperable receiver available to the public").

[26] *See* Application at 15 & n.37; Karmazin March 7, 2007 Congressional Testimony. *But see* XM Satellite Radio Holdings Inc., Annual Report on Form 10-K Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Fiscal Year Ended December 31, 2006 ("XM 2006 10-K") at 13 ("We have signed an agreement with SIRIUS Radio to develop a common receiver platform combining the companies' proprietary chipsets, but the companies have not completed final design of an operational radio using this platform.").

[27] Application at 16.

[28] *Id.* The Applicants also state that "[t]hese interoperable radios are currently larger, consume more power, and are more expensive and less feature rich than the current single-system radios." *Id.* Whether part of a strategic design or not, the companies' failure to offer interoperable receivers raises switching costs for consumers and thereby tempers competition between them with respect to existing customers, as reflected by the fact that there is "very little churn between the two companies." Testimony of Mel Karmazin Before the Antitrust, Competition Policy and

arguendo that Applicants are in compliance with the interoperable receiver requirement,[29] a merger is not necessary for the commercialization of interoperable receivers.[30] The problem of the lack of subsidies could be solved by a joint venture between the Applicants (subject to oversight by the Commission) to subsidize interoperable receivers, or by a rule requiring the companies to offer subsidies for interoperable receivers comparable to those for non-interoperable receivers, or by a rule requiring all new satellite radios installed in automobiles to have an interoperable receiver.[31]

More diverse programming. The Applicants claim that "*[i]n the long-term*, the combined company will provide consumers with an even more diverse selection content" because "*[e]ventually*, the combined company will be able to consolidate much redundant programming."[32] However, as long as the merged company continues to operate two systems, which allows customers to receive substantially the same channel

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Consumer Rights Subcommittee of the Senate Judiciary Committee, *Hearing on the XM-Sirius Merger: Monopoly or Competition From New Technologies?*, March 20, 2007 ("Karmazin March 20, 2007 Congressional Testimony"). *See generally* Stanley M. Besen & Joseph Farrell, *Choosing How to Compete: Strategies and Tactics in Standardization*, 8 J. ECON. PERSP., Spring 1994, at 117, 121 ("most analysts believe that price competition is more intense when vendor[]s' products are compatible").

[29] The Commission has never ruled on the Applicants' compliance with the interoperable receiver requirement, *see* XM 2006 10-K at 13 ("the FCC has not expressly acknowledged our compliance"), and the situation hardly conforms to the Commission's original expectation that *all* receivers would be interoperable. *See DARS Report and Order*, 12 FCC Rcd at 5797, ¶ 106 ("at the very least, consumers should be able to access the services from all licensed satellite DARS systems and our rule on receiver inter-operability accomplishes this"); *see also id.* ¶ 105 (noting that Sirius expected "its receiver will be fully tunable in the sense that the consumer can select the service provider of their choice").

[30] Moreover, it is hard to see how an interoperable receiver would be a significant benefit to consumers, as Applicants claim, if the merger is allowed. Why would consumers need an interoperable receiver if they will be able to get the best of both services on their current incompatible receivers?

[31] *Cf. Consumer Electronics Ass'n v. F.C.C.*, 347 F.3d 291 (D.C. Cir. 2003) (upholding Commission order under All Channel Receiver Act requiring all new televisions to include a tuner capable of receiving digital television signals).

[32] Application at 12, 13 (emphasis added).

line up of either Sirius or XM on their existing receivers, there can be no additional programming. Indeed, until the merged company adopts a single system, the diversity of programming available to the public will be *reduced* because the Applicants promise to use existing channel capacity to provide the "best of both" services on each service. This means that the opportunities for niche programmers will be reduced over the foreseeable future. When will the benefits of more diverse programming begin to occur? According to Sirius CEO Mel Karmazin, the merged company would not be able to operate on one platform until at least 2017 or 2018.[33] Long-term indeed! In *EchoStar/DirecTV*, where the merging parties intended to consolidate their systems using a single set-top box within *three years* of the merger, the Commission found that the efficiencies from consolidation were sufficiently distant to be "inherently speculative."[34]

Even if the Applicants could consolidate their systems sooner, it is not clear that the merger would necessarily result in more diverse, richer programming. In its DARS Order, the Commission noted "that licensees will have an incentive to diversify program formats and thereby provide valuable niche programming."[35] The Commission's prediction of programming diversity has proven correct. The two companies have competed fiercely to offer differentiated, exclusive, and original programming.[36]

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[33] Karmazin March 7, 2007 Congressional Testimony.

[34] *EchoStar/DirecTV Order*, 17 FCC Rcd at 20634, ¶ 202.

[35] *DARS Report and Order*, 12 FCC Rcd at 5762, ¶ 15.

[36] Only 12 of the channels offered by the Applicants are identical. *See* Application at 12-13 & n.29. According to the Applicants, a further 75 channels overlap by genre, *id.* at 12, but many of these channels are quite distinct. *See, e.g.,* Marc Fisher, *XM vs. Sirius: Endless Options Narrow to One*, WASHINGTON POST, Apr. 13, 2006, at N01 (cataloguing distinctions between XM and Sirius channel offerings within genres, noting that while "tunes are often similar; how they're presented is the difference"); Sarah Bryan Miller, *Classical fans make a heavenly connection: Satellite radio offers listeners more choices*, ST. LOUIS POST-DISPATCH, March 18, 2007, at F1 (noting differences between each service's lineup of 3 classical music channels).

In *EchoStar/DirecTV*, the parties' program variety claim was much stronger than in this case. There, the DBS operators provided a far greater percentage of duplicated programming; indeed, they were retransmitting over 500 identical channels of programming (mostly local television signals), and a merger would have freed up this spectrum for more local channels and other program offerings and services. However, the Commission rejected the "spectrum efficiency" benefits as a justification for the merger. Beyond the timing issue, the Commission concluded that while the merger would make the resulting company "a more *capable"* competitor to cable companies, it would be a "less *effective* competitor"[37] because "the Applicants' incentives to carry through on their promises of enhanced competition [for example, by offering local broadcast signals in more local markets] will be decreased, rather than increased."[38] So too here, eliminating competition between Sirius and XM would reduce their incentives to offer a greater variety of programming, even if (over the long term) the combination increases their ability to do so.

Further, in terms of programming diversity, the issue is not merely the variety of channels, but the diversity of *programming viewpoints*. Indeed, one of the Commission's principal objectives in having at least two DARS licensees was to "provide for a diversity of programming voices."[39] This diversity means, among other things, that programmers seeking access to satellite radio's national platform can do so through two competing outlets, rather than a single gatekeeper. For example, in February of this year, Sirius dropped C-SPAN radio because C-SPAN refused to allow Sirius to preempt its

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[37] *EchoStar/DirecTV Order*, 17 FCC Rcd at 20663, ¶ 282 (emphasis added); *see also id.* at 20639, ¶ 217.
[38] *Id.* at 20664, ¶ 284. The Commission also noted the merged firm's reduced incentives to invest in technology to increase the efficiency of spectrum use. *See id.* at 20633, ¶ 201.
[39] *DARS Report and Order*, 12 FCC Rcd at 5786, ¶ 78.

programming for sports events. XM continues to broadcast C-SPAN without preemption. What would the merged firm do? Given the reduced channel capacity available for the foreseeable future, Sirius's approach seems likely to prevail. What would C-SPAN do? It would have no choice but to accept Sirius's terms if it wished to reach satellite radio's national audience.[40] Preserving two programming voices ensures that the public gets the benefit of the possibility of different approaches to the sports/public affairs tradeoff. Diversity of voices is also important because of the unregulated character of the content of satellite radio. While both companies currently capitalize on their ability to broadcast "adult" content, they differ in their promotion of this type of programming, and may differ in the future on the limits of such programming.[41] One of the grounds for rejecting the EchoStar/DirecTV merger was that it "would disserve the Commission's policy goal of viewpoint diversity" by the "elimination of one nationwide DBS editor."[42] So too here, viewpoint diversity would be impaired, and the Applicants do not claim otherwise.

Other efficiencies. The Applicants claim that the merger will help accelerate the deployment of advanced technology, but offer only the vaguest suggestions as to how this might occur (e.g., "better results from each dollar invested in research and development") and no indication why such benefits "would not be possible absent the proposed transaction."[43] This claim hardly comes close to satisfying their burden of proving a public-interest benefit. Further, the Applicants claim that the merger will allow the two

[40] C-SPAN radio is available over the air in Washington/Baltimore metropolitan area. It is also available nationwide over the Internet, but that is not a substitute for reaching people in their cars.
[41] *Cf. XM Suspends Pair for On-Air Remarks*, WALL ST. J., May 16, 2007, at B4 (XM suspended Opie and Anthony for 30 days for making offensive comments).
[42] *EchoStar/DirecTV Order*, 17 FCC Rcd at 20585, ¶ 55.
[43] Application at 14-15.

companies to achieve "large-scale operational efficiencies" which "can be passed on to subscribers in the form of lower subscription rates."[44] However, the so-called "operational" efficiencies identified by the Applicants appear to be largely speculative, not merger specific, or involve fixed rather than marginal costs.[45] The Commission has recognized, as do the horizontal merger guidelines, that efficiencies must be verifiable, merger specific, and likely to result in lower equilibrium prices.[46]

III. The Merger Poses a Significant Risk of Anticompetitive Effects, Including Higher Prices, Reduced Quality and Reduced Consumer Choice.

The Applicants claim that the merger is not anticompetitive because satellite radio competes in the broad market for "audio entertainment services," which includes terrestrial radio, as well as HD radio, Internet radio, iPods and other MP3 players, mobile phones, and CD players. The Applicants recognize that the critical question for antitrust merger analysis is whether the merged firm would be able to exercise market power,[47] but claim that such a result is not likely because the combined company would have only

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[44] Application at 17.

[45] The Applicants identify the following efficiencies: 1) "eventually reduce duplicative programming expenses"; 2) "reduce operational expenses for infrastructure used to broadcast and transmit satellite radio programming"; 3) reduction in marketing and subscriber acquisition costs, including focusing marketing dollars "not simply to drive brand awareness, but also to reduce consumer confusion over what satellite radio offers"; 4) "reduce the cost of duplicative research and development efforts that would otherwise be necessary to ensure the Applicants remain competitive in the market for audio entertainment services"; 5) reduce duplicative General & Administrative expense. Application at 17-18. They cite certain stock analysts' reports estimating cost synergies at $200 to $400 million over the short term, and in the billions over the long term, Application at 18 nn.38, 39, but provide neither independent estimates nor detailed analysis of the efficiency claims. Other stock analysts have expressed skepticism of the synergy claims. *See, e.g.,* Thomas W. Egan & Dorothy P. Tse, *While Approval Likely, Skeptical on Synergies*, Oppenheimer Industry Update, Feb. 20, 2007, at 1 ("We remain skeptical of the $5bn-$6bn range of synergies available from the merger.").

[46] *See EchoStar/DirecTV Order*, 17 FCC Rcd at 20630-31, ¶¶ 189-191 (noting that reductions in marginal costs more likely to be cognizable than reductions in fixed costs because they directly affect firm's pricing incentives).

[47] Market power is ordinarily defined as the ability to maintain prices above the competitive level or reduce quality below the competitive level for a significant period of time. *See* Dept. of Justice & Federal Trade Commission Horizontal Merger Guidelines § 0.1.

a small share of the market for audio entertainment services. However, if satellite radio is a relevant antitrust market, then by hypothesis the combined firm, as a monopolist, will be able to exercise unilateral market power in that market,[48] particularly since new entry is unlikely.[49] The fact that terrestrial radio and other sources of audio entertainment services are substitutes for satellite radio for some people and some uses -- and compete to some extent with satellite radio -- does not disprove the existence of a satellite radio market.[50] Rather the pertinent question for antitrust analysis is whether these alternatives are sufficiently substitutable that it would be unprofitable for a satellite radio monopolist to raise its price above the competitive price because it would lose more from reduced sales than it would gain from higher prices on the sales that would not be lost. This is standard horizontal merger guidelines analysis, which the Applicants do not address.[51]

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[48] Even if the market is defined broadly to include other sources of audio entertainment, the merged firm still may be able to exercise market power. Under a theory of unilateral effects in a differentiated product market where the merged firms are their closest competitors, a merger might result in a price increase regardless of the combined firm's market share. Thus, for example, in the DirecTV/EchoStar merger, where the Commission assumed for purposes of analysis that the relevant market included cable as well as satellite multichannel video programming services, the Commission noted that "the record suggest[s] that the services provided by DirecTV and EchoStar are significantly closer substitutes than those offered by cable systems. This strongly suggests that, in the absence of any significant saving in marginal cost, the merger will result in a large [unilateral] increase in post-merger equilibrium prices." *EchoStar/DirecTV Order*, 17 FCC Rcd at 20624, ¶ 169. (Under the horizontal merger guidelines, if prices would increase by more than 5% then the broader market definition is incorrect.) The possibility of price caps as a means to mitigate market power concerns is discussed *infra*.

[49] *See* Karmazin March 20, 2007 Congressional Testimony ("[A]sking whether I think there will be another satellite competitor[;] the answer will be probably not.").

[50] *Cf. F.T.C. v. Staples, Inc.*, 970 F. Supp. 1066 (D.D.C. 1997) (finding that consumable office supplies sold through office supply superstores was a relevant market notwithstanding that such supplies were available at many other outlets, including Wal-Mart).

[51] The Applicants point to the Fall 2006 Arbitron survey showing that satellite radio accounts for only 3.4% of all radio listening. But satellite radio's share of radio listening says little about the cross elasticity of demand between terrestrial radio and satellite radio. If anything, the Arbitron survey suggests that the cross elasticity is not high, as satellite radio users have not abandoned terrestrial radio; indeed, they listen to more terrestrial radio than satellite radio. *See* Katy Bachman, *Arbitron: XM/Sirius Would Nab 3.4% of Listeners*, MEDIAWEEK.COM, Feb. 27, 2007 (Aribitron survey shows satellite radio listeners are heavy radio listeners, spending an average of 33 hours per week listening to radio, including 14 hours with AM/FM and 10.75 hours with

What makes this merger analysis somewhat atypical is the fact that satellite radio is a relatively new product whose current market penetration (about 14 million subscribers) is expected to double by 2010.[52] And the merging firms have yet to earn a profit, although Sirius achieved positive free cash flow in the fourth quarter of 2006.[53] Thus, in analyzing the merger, the Commission must not only be concerned about whether the merger would create or strengthen the ability of the merged firms to exercise market power immediately after the merger, but also over the next few years as demand grows and the market matures.[54] This is no small concern because Sirius's business plan as a separate company indicates that it expects to cut back on "subsidies" for receivers over time (i.e., raise prices to consumers).[55] Moreover, Karmazin told analysts in 2006 that "in the future there will be price increases coming from Sirius."[56]

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satellite radio); *cf.* Bridge Ratings, Radio Format Perceptual – Spring 2006, at http://www.bridgeratings.com/press.06.22.06.Formats.htm (in survey of radio listeners, while 36% said that time spent with satellite radio causes them to listen less to traditional radio, 23% said that time spent with satellite radio causes them to listen more to conventional radio, and 41% said that there was no effect). The Commission anticipated that satellite radio would complement terrestrial radio as much as substitute for it. *See DARS Report and Order*, 12 FCC Rcd at 5756, ¶ 1 ("While, to some extent, DARS will compete with local radio, we anticipate that it will also complement terrestrial radio."); *id.* at 5764, ¶ 21 ("[W]e believe that owners of satellite DARS receivers will continue to allocate a significant share of their listening time to terrestrial radio in order to hear music or news of local interest.").

[52] *See* Application at 22 & n. 48 (citing studies predicting 25 million to 30 million subscribers by 2010).

[53] Sirius Satellite Radio Inc., Annual Report on Form 10-K Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Fiscal Year Ended December 31, 2006 ("Sirius 2006 10-K") at 27.

[54] Given their losses to date, it may seem incongruous to say that the firms are currently exercising market power, but the current duopoly subscription price may well exceed the competitive price that would prevail once the firms reach viable operating scale, particularly in light of their low variable costs. *See Q1 2007 Sirius Satellite Radio Earnings Conference Call -- Final*, FD (FAIR DISCLOSURE) WIRE, May 1, 2007 (firm's "contribution margin," i.e. percentage of incremental revenue that exceeds variable costs, exceeds 70%).

[55] *See* Sirius 2006 10-K at 9 ("We expect these subsidies [for radios] to decrease over time."). Significantly, Sirius recognizes that competition from XM may thwart those expectations. *See id.* at 32 ("If competitive forces ... require us to increase hardware subsidies or promotions, SAC [subscriber acquisition costs] ... may increase."); Sirius Satellite Radio Inc., Annual Report on Form 10-K Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Fiscal

There is some evidence that the demand for satellite radio is somewhat inelastic at current prices and level of demand. Karmazin himself is quoted as stating earlier this year, "'there is elasticity' [sic] in the price given high subscriber satisfaction with product, low churn and higher fees in Canada. While no price increase is imminent, it is 'a good option,' he said."[57] In April 2005, XM raised its subscription price by 30% from $9.99 to $12.95 per month, matching Sirius's price,[58] with apparently little diminution in demand. According to a report at the time, "Hugh Panero, chief executive at XM, [said] he doesn't believe his business [would] lose customers because of the higher monthly price."[59] Evidently he was correct, as the number of XM subscribers jumped by 84% in 2005,[60] and subscriber growth in the last three quarters of 2005 (i.e., following the price

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Year Ended December 31, 2005 ("Sirius 2005 10-K") at 18 ("If the costs of attracting subscribers are greater than expected or if our competitor, XM Radio, substantially increases equipment subsidies or reduces hardware prices, our financial performance and operating results could be adversely affected.").

[56] *Q1 2006 Sirius Satellite Radio Earnings Conf. Call -- Final*, FD (FAIR DISCLOSURE) WIRE, May 2, 2006. *See also* Eileen Furukawa, *Satellite Communications: Regulatory Approval is Key Hurdle w/ Stocks Reflecting Low Success Probability*, Citigroup, Multi-Company Note, Feb. 21, 2007, at 7 (forecast assumes rising average revenue per subscriber for Sirius, driven in part by monthly subscription rate increases; "but if either competitor changes its strategy and attempts to drive market share gains through lower monthly subscription prices, this would have a significant impact on our top line forecast going forward").

[57] Georg Szalai, *CBS: Web Revenue to Double*, BRANDWEEK.COM, Jan. 11, 2007; *see also Sirius Satellite Radio at Credit Suisse Media & Telecom Week,* FD (FAIR DISCLOSURE) WIRE, Dec. 6, 2006 ("we think there is an opportunity for us to increase our pricing") (Karmazin); *Q4 2005 Sirius Satellite Radio Earnings Conf. Call -- Final*, FD (FAIR DISCLOSURE) WIRE, Feb. 17, 2006 (same); *Technology Briefing*, WASHINGTON POST, Dec. 8, 2005, at D5 ("Sirius Satellite Radio has no plans to raise prices, but the New York-based company said studies it has done show it can raise its subscription price without alienating consumers.").

[58] *See* Sarah McBride, *XM Raises Subscription Price, Matching Rival Sirius Satellite*, WALL ST. J., March 1, 2005, at D4. The price increase went into effect on April 2, 2005. *See* XM Satellite Radio Holdings Inc., Annual Report on Form 10-K Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Fiscal Year Ended December 31, 2005 ("XM 2005 10-K") at 37. Prepaid annual and multi-year subscribers, who comprised 40% of XM's subscribers in the second quarter, were not affected until their subscriptions expired. *See Q3 2005 XM Satellite Radio Earnings Conf. Call -- Final,* FD (FAIR DISCLOSURE) WIRE, Oct. 27, 2005.

[59] McBride, *supra* note 58, at D4.

[60] *See* XM 2005 10-K at 37.

increase) was significantly higher than during the same periods of the prior year.[61] To be sure, subscriber growth may have been even higher without the price increase, and XM's "conversion rate" decreased slightly in 2005.[62] Moreover, XM's higher subscription prices were partly offset by lower prices for satellite radios in the retail channel.[63] Significantly, however, the churn rate (reflecting deactivated paying subscribers) did not increase in the second and third quarters of 2005,[64] and increased only slightly thereafter,[65] indicating that existing subscribers were relatively insensitive to the price increase.[66]

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[61] The number of net subscribers added was 55% higher in the second quarter of 2005 as compared to the second quarter of 2004, *see* XM Satellite Radio Holdings Inc. Announces Second Quarter 2005 Results and Increases Year-End Subscriber Guidance to 6 Million, Press Release, July 28, 2005, 48% higher in the third quarter, *see Q3 2005 XM Satellite Radio Earnings Conf. Call -- Final*, FD (FAIR DISCLOSURE) WIRE, Oct. 27, 2005 (Panero noting that "[o]ur significant third-quarter subscriber growth occurred in the face of a new rate structure instituted in the prior quarter and a softer market for new car sales"), and 26% higher in the fourth quarter. *See Q4 2005 XM Satellite Radio Earnings Conf. Call -- Final*, FD (FAIR DISCLOSURE) WIRE, Feb. 16, 2006. As Sidak points out, "The fact that subscriber growth continued at such a rapid pace in the presence of [a] 30 percent price increase underscores the low elasticity of demand faced by SDARS providers." *See* Expert Declaration of J. Gregory Sidak Concerning the Competitive Consequences of the Proposed Merger of Sirius Satellite Radio, Inc. and XM Satellite Radio, Inc. ¶ 22 (March 16, 2007).

[62] The "conversion rate" is the rate at which OEM (new automobile) customers subscribe after receiving a 3-month free trial period. *See* XM 2006 10-K at 41. It declined in 2005 to 56.9% from 58.9% in 2004, which XM attributed primarily to the April 2005 30% rate increase. *Id.* at 42.

[63] *See* Laura Petrecca, *XM Satellite Radio offering $50 rebate*, USA TODAY, Dec. 8, 2005, at 3B; XM 2006 10-K at 47.

[64] *See* XM Satellite Radio Holdings Inc., Selected Balance Sheet Data and Statistics, at http://media.corporate-ir.net/media_files/IROL/11/115922/Q2Stats.pdf (visited May 31, 2007) (churn rate for each of first three quarters of 2005 was approximately 1.4%).

[65] *See id.* (churn increased in fourth quarter of 2005 to 1.57%); XM 2006 10-K at 41-42 (noting that churn increased from 1.46% in 2005 to 1.77% in 2006 partly as a result of termination of previous customer service provider and transition to a new customer service provider). Sirius experienced a more pronounced increase in churn without any increase in subscription prices. *See* Sirius 2006 10-K at 32 (churn increased from 1.5% in 2005 to 1.9% in 2006).

[66] XM's price increase significantly boosted its monthly subscription revenue per subscriber (ARPU) between 2004 and 2006. *See* XM 2006 10-K at 37. The Commission recently noted that "ARPU is [a] metric widely used in retail communications businesses. Falling ARPU can indicate decreases in price or increases in the quantity of service offered at a given price, either of which may indicate increasing competition or, at least, improved market performance for

In contrast to his earlier statements, Karmazin has recently suggested in congressional testimony that the merged company would be constrained from raising subscription prices in order to attract listeners from free over-the-air radio. "I don't know if there's anybody who sort of follows it a little bit, but when you're trying to get subscribers and you're charging $12.95, you're more apt to get a subscriber than if you're going to charge $14.95," he testified. "If the option is free, why on earth would there be higher prices?"[67] The short answer is whether competition from free over-the-air radio keeps satellite radio prices down depends on the cross elasticity of demand between satellite and terrestrial radio, as to which the Applicants have supplied no data.[68] Further, the fact the industry is still in its penetration phase seeking to attract subscribers new to satellite radio does not make a price increase less likely given the ability (and practice) of the Applicants to price discriminate between new and old subscribers by, for example, providing rebates or discounts on the purchase of satellite radios. Moreover, the potential gains from keeping subscription prices low to attract new subscribers will diminish over time as penetration matures, while the gains from raising prices on the growing subscriber base will increase.

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consumers." *Annual Report and Analysis of Competitive Market Conditions with Respect to Domestic and International Satellite Communications Services*, FCC 07-34, at ¶ 167 (Mar. 26, 2007). In the satellite radio market, however, the Commission noted that ARPU for both SDARS providers was increasing. *See id.* ¶ 158.

[67] Karmazin March 7, 2007 Congressional Testimony. Karmazin has also emphasized that "the vast majority of the subscribers we're looking to gain are the 90% of the people who are currently not subscribers to satellite radio." *Sirius Satellite Radio and XM Satellite Radio to Combine in Merger of Equals*, FD (FAIR DISCLOSURE) WIRE, Feb. 20, 2007; *see also* XM 2006 10-K at 41 ("We target the over 240 million registered vehicles and over 110 million households in the United States.").

[68] A degree of cross elasticity might be shown if the rate of satellite radio subscriptions is higher in markets with fewer terrestrial radio stations. On the other hand, if the rate of satellite subscriptions is geographically uniform throughout the country, this would tend to indicate little cross elasticity.

The Applicants themselves have articulated what makes satellite radio unique: an "endless variety" of programming, much of which is not available on terrestrial radio, including dozens of commercial-free music channels, musical formats unavailable in many radio markets, niche programming made possible by aggregating demand, comprehensive sports coverage, including a vast array of out-of-market games, "adult" programming, coast-to-coast listening or portability, and CD-quality sound.[69] The Commission recognized many of these unique attributes of satellite radio in its DARS Order, when it expected each satellite provider to be offering only 19 to 44 channels instead of the current 130 to 170 channels.[70]

Each of the alternatives to satellite radio has significant limitations in constraining a satellite radio monopolist from exercising market power. Terrestrial radio, the most realistic competitor, offers far fewer channels,[71] less diverse content, no commercial-free

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[69] *See* XM 2006 10-K at 1, 36 ("XM Radio appeals to consumers because of our innovative and diverse programming, nationwide coverage, many commercial-free music channels and digital sound quality."); *id.* at 2 ("XM Radio offers many music formats that are popular but currently unavailable in many markets on radio."); *Q3 2006 XM Satellite Radio Earnings Conf. Call -- Final*, FD (FAIR DISCLOSURE) WIRE, Nov. 6, 2006 ("[S]atellite radio is not simply about each quarter's results, it's also about pioneering a whole new generation of radio that leverages next-generation satellite and digital technology to offer millions of consumers unparalleled choice, unprecedented range of compelling programming across a spectrum of content, including news, information, sports, and music, convenience and portability, high-quality audio, and, of course, exceptional value.") (Panero).

[70] The Commission noted that "additional high quality audio signals" and radio formats would be a particular benefit to areas underserved by terrestrial radio stations, *DARS Report and Order*, 12 FCC Rcd at 5760, ¶ 11, that "[w]ith its national reach, satellite DARS could provide continuous radio service to the long-distance motoring public," *id.* at 5760-61, ¶ 13, and that "[s]atellite DARS may also be able to foster niche programming because it can aggregate small, nationally dispersed listener groups that local radio could not profitably serve." *Id.* ¶ 14.

[71] Even the largest 10 markets have only about 54 commercial stations on average. *See, e.g.,* F.C.C., Mass Media Bureau, Review of the Radio Industry, 2001, App. A (Sept. 2001), at http://www.fcc.gov/mb/policy/docs/radio01.pdf.

music,[72] poorer sound quality, and is not geographically continuous. HD radio, which is just emerging, has high sound quality and will boost the number of available stations in many markets,[73] but still offers far less variety than satellite radio, no marquee content, little commercial-free music, is not continuous, and has had limited success in getting HD radios into automobiles.[74] iPods and other MP3 players, while becoming ubiquitous, offer a vastly different experience than what radio offers (i.e. programmed content, live events) and are to a significant extent complements to satellite and terrestrial radio.[75] While wireless technology and Internet radio appear to offer the potential for

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[72] Recent reports indicate that radio stations in the top 15 radio markets average 9.42 minutes of commercials per hour. *See* EPM Communications, Inc., *Radio advertising varies by market and format*, 24 Research Alert No. 23, Dec. 1, 2006, at 10.

[73] The Applicants note that 500 sidebands of HD Radio multicasts are available in 50 U.S. markets, Application at 27, but the maximum number of channels in any one market (Los Angeles) is 57. *See* http://www.hdradio.com/find_an_hd_digital_radio_station.php (last visited May 31, 2007).

[74] *See, e.g.,* Bridge Ratings, Digital Media Growth Projections – Updated 04/25/2007, at http://www.bridgeratings.com/press_042507-digitalprojectionsupd.htm ("[O]f all the media we are covering in this latest study, HD Radio growth is the most disappointing based on previous industry expectations."); *XM Satellite Radio at Goldman Sachs Communacopia XV Conference -- Final*, FD (FAIR DISCLOSURE) WIRE, September 20, 2006 (XM Chairman Gary Parsons stated, "I think HD radio or iBiquity still has a real struggle because there is no effective way for them to actually compensate the car companies to influence putting it in, and it's difficult to put that compelling mix together."). The only car manufacturer to offer HD radio is BMW, which will offer HD radio as an option on all of its vehicles this year. *See* John R. Quain, *Local Radio is Cutting the Static and Going Digital, Finally,* N.Y. TIMES, Mar. 25, 2007, at 12:2 (reporting that BMW spokesman pointed out that listeners did not have to choose between satellite and HD radio as many models come with both). By contrast, either XM or Sirius radios are available from all of the major auto manufacturers in a large proportion of their vehicles. *See* William Kidd & Jung Hwang, *XM Satellite Radio (XMSR): Q1 Results Meet Lowered Expectations*, Wedbush Morgan Securities, Equity Research, April 27, 2007, at 5-7.

[75] As the Applicants point out, they both introduced satellite radios with built-in MP3 players. *See* Application at 44-45. iPods apparently have had little effect on the penetration of satellite radio in automobiles. *See XM Satellite Radio at Goldman Sachs Communacopia XV Conference -- Final*, FD (FAIR DISCLOSURE) WIRE, Sept. 20, 2006 (Parsons stated that "in those places where even a full iPod integration has been available to be done, which include with some of our partners, the … penetration of that versus what we do is vastly in our favor"); *see also* Patrick Goldstein, *XM radio: It's out of this world*, LOS ANGELES TIMES, July 26, 2005, at E1 ("What makes XM such a brilliant concept is that in a musical era when, through downloading, we can get pretty much any kind of music anytime we want, listeners are desperate for a mediator – a savvy tastemaker – who can help us separate the wheat from the chaff.").

subscription-based services comparable in many respects to those offered by the Applicants, it is not clear when or if that potential will be reached, and there is no evidence to suggest that any such service is likely to be a full fledged competitor to XM or Sirius in next few years.[76] Finally, as others have pointed out, while XM and Sirius both market their services against terrestrial radio, as well as one another, they have apparently not promoted their services against any other technology, nor do they measure themselves against any other competitor.

To whatever extent satellite radio competes with terrestrial radio and other alternatives, it is clear that XM and Sirius compete more directly with one another.[77] Indeed, this seems to be one of Wall Street's complaints about the two companies.[78] For example, in their SEC filings, each company refers to the other as its "direct competitor,"

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[76] The Applicants make reference to numerous press reports of wireless music or Internet radio services that are at various stages of development, including some that have not panned out (*see, e.g.,* Mike Hughlett, *Moneymaking issues delay Motorola's iRadio*, CHICAGO TRIBUNE, Mar. 12, 2007, at Bus. 7), but no analysis (external or internal) that suggests such services pose a meaningful competitive constraint on satellite radio. Indeed, both XM and Sirius have entered ventures to distribute some of their music programming through wireless services. *See* Tony Sanders, *Satellite Radio: How Big? How Long?*, BILLBOARD RADIO MONITOR, Dec. 2, 2005 (both companies emphasizing that cell phones could be used to deliver satellite radio content).

[77] The Applicants suggest that their conduct has been "responsive" to other forms of audio entertainment, citing the fact that they significantly expanded their channel capacity from their original plans, introduced local weather and radio channels, and introduced satellite radios with built-in MP3 players. Application at 44. But these moves were likely intensified by the competition between them, just as competition between EchoStar and DirecTV sped their rollout of local-into-local services, which was responsive to cable competition. *See, e.g.,* Katy Bachman, *Satellite Radio to broadcast local traffic, weather*, MEDIAWEEK.COM, Jan. 8, 2004 (reporting that both XM and Sirius announced plans to roll out local traffic and weather services); *Digital Radio*, CONSUMER ELECTRONICS DAILY, July 27, 2005 (reporting that XM was introducing the first MP3 players with satellite radio capability and that Sirius also had a device with an MP3 player in the works).

[78] *See, e.g.,* Laraine Mancini, et al., *Sirius Satellite Radio Inc.: And then there was one*, Merrill Lynch, Company Update, Feb. 20, 2007, at 3 ("the combined company … will be able to better focus on providing a compelling product to consumers instead of battling for market share").

or its "competitor."[79] In conference calls with stock analysts, they measure their performance against each other[80] and consider market share of satellite subscribers to be a key metric.[81] Sirius has described the competition between it and XM as follows:

> We compete vigorously with XM Radio for subscribers and in all other aspects of our business, including the pricing of our service and our radios, retail and automotive distribution arrangements, programming acquisitions and technology. Competition with XM Radio may increase our operating expenses as we seek arrangements with third parties, such as programming providers, and may cause us to reach cash flow breakeven with more subscribers or later than we estimate.[82]

The evidence of this vigorous head-to-head competition is considerable, except currently in the area of subscription pricing, where price competition ended in April 2005 when XM raised its prices to match Sirius's prices.[83] Now, the companies charge the same amount for a monthly subscription ($12.95), a one-year subscription ($142.45), a

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[79] XM 2005 10-K at 13 ("Our direct competitor in satellite radio service is Sirius Radio, the only other FCC licensee for satellite radio service in the United States."); Sirius 2005 10-K at 10 ("Our direct competitor in satellite radio service is XM Radio, the only other FCC licensee for satellite radio service in the United States."); *see also id.* at 18 (referring to XM as "our competitor"); XM 2006 10-K at 47 (referring to Sirius as "our competitor").

[80] The "yardstick" competition between the firms not only reflects their perception of the relevant market, but allows investors to better monitor the firms' performance, *see infra* note 18, and benefits the firms themselves. *See, e.g., Q4 2005 Sirius Satellite Radio Earnings Conf. Call -- Final*, FD (FAIR DISCLOSURE) WIRE, Feb. 17, 2006 (Karmazin stating, "We have the benefit of learning from what has happened with [XM] to ensure that the same thing does not happen to us or that we're able to learn from it and it doesn't happen quite in the same way.").

[81] *See, e.g., Q4 2006 Sirius Satellite Radio Earnings Conf. Call -- Final*, FD (FAIR DISCLOSURE) WIRE, Feb. 27, 2007 (Karmazin emphasizing Sirius's growing share of satellite radio growth during 2006; "the information that I get every single week still indicates Sirius has got the leading share at retail"); *Q3 2006 Sirius Satellite Radio Earnings Conf. Call -- Final*, FD (FAIR DISCLOSURE) WIRE, Nov. 8, 2006 (Karmazin emphasizing Sirius's increasing market share of net additions).

[82] Sirius 2005 10-K at 19.

[83] Previously, XM charged $9.99 per month and Sirius charged $12.95 per month but sometimes offered discounts on subscriptions. *See Q4 2003 Sirius Satellite Radio Earnings Conf. Call -- Final*, FD (FAIR DISCLOSURE) WIRE, Jan. 28, 2004 (explaining retail promotion offering subscribers three free months when they sign up for a full year of Sirius service, bringing customer's cost down to just over $10 per month). When it raised its monthly subscription fee, XM also matched Sirius by eliminating extra charges for its premium programming ($1.99 per month for the Opie & Anthony channel) and Internet service. *See* McBride, *supra* note 58, at D4.

two-year subscription ($271.95), and additional subscriptions or "family plan" ($6.99).[84] Yet while the identity of pricing means that subscription pricing is not presently a front in the competitive battle between the two companies,[85] it strongly underscores the fact that XM and Sirius are very close substitutes for one another.[86]

Competition between XM and Sirius to offer attractive programming has been fierce, as demonstrated by the millions of dollars they have spent to obtain sports programming (e.g., NFL, MLB, NASCAR, NHL, and NBA), adult programming (e.g., Howard Stern, Opie & Anthony, Playboy channel), women's programming (e.g., Martha Stewart, Oprah Winfrey), exclusive music artists and series (e.g., Bob Dylan, Jimmy Buffet), and other programming, in many instances bidding against each other for the same programming rights.[87] That these programming deals are exclusive to each service confirms the obvious fact that they have been driven to a significant extent by competition between the two satellite providers to attract subscribers.[88] Competition to

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[84] The subscription prices for the companies' specialized traffic and weather services (which require additional equipment) are also largely the same -- $9.95 per month each for Sirius Traffic and XM NavTraffic, and $29.95 per month each for Sirius Marine Weather and XM WX Satellite Weather (Marine).

[85] The identity of pricing does not necessarily suggest collusion in the context of a tight oligopoly, although the degree to which the firms publicly discuss their pricing strategies is somewhat surprising. *See infra* note 90; *see also XM Satellite Radio at Citigroup 17th Annual Entertainment, Media and Telecommunications Conf.*, FD (FAIR DISCLOSURE) WIRE, Jan. 9, 2007 (asked whether XM would match a Sirius rate increase, XM Chairman Parsons told investors that XM would not likely do so because it was too soon after XM's 2005 price increase; "we might use it to gain share for a while and then institute it and match at a later time").

[86] *See EchoStar/DirecTV Order*, 17 FCC Rcd at 20622, ¶ 162 (noting that prices that EchoStar and DirecTV charged were "remarkably similar," which suggested that EchoStar and DirecTV were "close substitutes in the eyes of MVPD consumers").

[87] *See* Tom Lowry and Paula Lehman, *Competition – Type A Organizations: Satellite R; Grudge Match*, BUSINESS WEEK, Aug. 21, 2006 (noting that the companies outbid one another for the rights to the NFL, Howard Stern, and MLB).

[88] Until recently, XM's website featured a detailed side-by-side comparison of XM and Sirius programming. *See* http://web.archive.org/web/20060427204408/www.xmradio.com/learn/programming.jsp. Sirius also previously featured a comparison with XM ("Brand X") on its web site, entitled "Critics Agree: Sirius is Better." *See* http://web.archive.org/web/20060101170338/

offer attractive programming has benefited consumers not only by providing more original and marquee content, as each firm has responded to the other's programming moves with its own programming additions, but also at least in one instance by leading one firm to respond to a programming move of the other with discounts on equipment.[89] The companies have also regularly engaged directly in competition over equipment pricing[90] and features.[91] The companies have also competed to obtain (and retain) exclusive distribution agreements with automobile manufacturers.[92] While these exclusive agreements, combined with the lack of receiver interoperability, have a

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http://www.sirius.com/servlet/ContentServer?pagename=Sirius/CachedPage&c=Page&cid=1065475754125.

[89] For example, in late 2005, in anticipation of Howard Stern's move to Sirius, XM lowered its prices on portable and home radios with rebates and other deals. *See* Petrecca, *supra* note 63, at 3B; *see also* XM 2006 10-K at 47 (noting that increase in subscriber acquisition costs in 2005 was "primarily the result of the increase in negative margins on direct hardware sales, subsidies and promotions during the fourth quarter of 2005 as a result of our response to control retail hardware price points to compete with the launch of Howard Stern by our competitor"; media spending also increased in 2005 to counter competitive pressures). Apparently, Stern's move was also partly responsible for XM's decision to end the extra fees it had charged for Opie & Anthony, XM's closest alternative to Stern. *See* McBride, *supra* note 58, at D4. Programming competition also led XM to follow Sirius's strategy of making its music stations 100% commercial free. *See Q4 2003 Sirius Satellite Radio Conf. Call -- Final*, FD (FAIR DISCLOSURE) WIRE, Jan. 28, 2004 ("Our strong premium programming position with commercial-free music and a powerful sports lineup … has clearly forced our competition to reevaluate its pricing and business model.").

[90] *See Q2 2006 XM Satellite Radio Earnings Conf. Call -- Final*, FD (FAIR DISCLOSURE) WIRE, July 27, 2006 (referring to the retail market, Panero stated that "there are competitive issues on some pricing right now [by "our competitor"] that we would want to react to in an intelligent way"); *Q2 2006 Sirius Satellite Radio Earnings Conf. Call -- Final*, FD (FAIR DISCLOSURE) WIRE, Aug. 1, 2006 (commenting on "philosophy" of pricing in the retail channel, a Sirius official stated, "it is not Sirius['s] intention to be the low price leader in the marketplace but instead to only react to lower prices if we need to to remain competitive."). *But see* Stephen Grocer, *Can XM Profit in Slowing Market? -- Controlling Costs Is a Key As Subscriber Growth Wanes*, WALL ST. J., Dec. 6, 2006 (quoting Lehman Brothers' analyst as stating that new attitude of companies to refrain from discounting "bodes well for the evolution of the satellite-radio industry into a profitable, rather than destructive, duopoly").

[91] *See, e.g.,* Petrecca, *supra* note 63, at 3B (noting that Sirius introduced the S50 portable radio to compete with XM's earlier introduction of its MyFi portable radio); *Digital Radio*, *supra* note 77 (noting competition to offer satellite radios with MP3 capability).

[92] While most of the automobile manufacturers have exclusive arrangements with either Sirius or XM, some offer both services, at least on some of their vehicles. Toyota for example offers XM as a factory-installed feature and Sirius as a dealer-installed option.

tendency to temper competition between the companies with respect to OEM (new automobile) subscribers,[93] they have not undermined the rivalry between the firms for "retail" or "aftermarket" subscribers, which remains the bulk of the industry's subscriber base.[94]

Some have suggested that the strong opposition to the merger by the National Association of Broadcasters (NAB) implies that the merger will be procompetitive. They reason that the NAB would not oppose the merger unless it would result in a loss of radio listeners to satellite radio, which would only come about if the merger made satellite radio a more compelling product for consumers. This theory is certainly worth investigating and, if correct, would be a factor militating in favor of permitting the merger.[95] But there are other plausible reasons that the NAB may be opposing the

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[93] The loss of "wholesale" competition between the two firms over retail distribution is of course a relevant consideration independent of its effect on consumers. *See F.T.C. v. H.J. Heinz Co.*, 246 F.3d 708, 719 (D.C. Cir. 2001) ("no court has ever held that a reduction in competition for wholesale purchasers is not relevant unless the plaintiff can prove impact at the consumer level"). But since car manufacturers likely take into account consumer satisfaction when choosing a satellite radio "partner," wholesale competition likely benefits consumers to some extent.

[94] As of the end of the first quarter of 2007, Sirius had 80% more retail than OEM subscribers, *see Sirius Satellite Radio Reports Strong First Quarter 2007 Results*, Press Release, May 1, 2007, while XM had 55% more aftermarket than OEM subscribers. *See XM Satellite Radio Holdings Inc. Announces First Quarter 2007 Results*, Press Release, Apr. 26, 2007. In assessing the competitive impact of the merger, it would be anomalous to consider as a favorable mitigating factor the fact that the firms have refrained from competing on subscription prices over the last two years, or that price competition between them is tempered by the lack of interoperable receivers or by the long term exclusive distribution agreements with automakers. These circumstances should not be presumed to persist in the future. *Cf.* Horizontal Merger Guidelines § 1.11 (where premerger circumstances are strongly suggestive of coordinated interaction, agencies' but-for analysis is not based on status quo prices).

[95] The strength of the theory is not that the NAB's opposition establishes that satellite radio competes against terrestrial radio, as the Applicants claim, *see* Application at 38, for such competition does not disprove the existence of a satellite radio market. *See supra.* Rather, the issue is what one can infer about the likely effects of the merger from the NAB's opposition. Some of its statements suggest that the NAB does anticipate consumer benefit. *See, e.g.,* David K. Rehr, President and CEO, National Association of Broadcasters, Statement Before the House Judiciary Committee Antitrust Task Force, Feb. 28, 2007, at 17 (contending that merged firm would "attempt to accelerate the acquisition of new subscribers by offering them a lower-cost point of entry"). But one should not take this too far. Even if the NAB perceived that the merger

merger that are entirely consistent with consumer harm. Unlike a direct competitor who benefits directly when a merged firm raises its prices,[96] any benefit to the NAB's members from higher satellite prices (increased demand for terrestrial radio) may be quite slight. And higher satellite prices that increase the merged firm's profitability (or other consequences of the merger that increase profitability but do not benefit consumers) may harm the NAB's members (or may be perceived to do so) insofar as such profits increase the ability of the merged firm to exclude broadcasters[97] or attract investment away from terrestrial radio. Or, the merger may harm the NAB's members by making the merged firm a more formidable competitor in the national advertising market.[98] Or, the NAB opposition may reflect its long-seated hostility towards satellite radio and a tribal-like perception (correct or not) that what is good for satellite radio companies must be bad for terrestrial radio. In short, the NAB's opposition does not necessarily imply that the merger will be good for consumers.

IV. A Regulatory Solution to the Competitive Harms Is Not Appropriate.

The Applicants have suggested that as a condition of the Commission allowing the merger they would be willing to agree on a subscription rate freeze for a period of time, which they maintain would prevent them from exercising any market power. The

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would result in benefits to consumers that would siphon away listeners, that perception could be mistaken or the benefits might not be merger specific.

[96] *See Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 583 (1986) (competitors "stand to gain from any conspiracy to raise the market price" and hence have no standing to challenge such a conspiracy).

[97] *See* Mary Quass, President and CEO NRG Media LLC, Statement on Behalf of NAB Before the Senate Judiciary Committee Subcommittee on Antitrust, Competition Policy and Consumer Rights, Mar. 20, 2007, at 11 ("There is also the very real risk that a combined XM/Sirius will use its market power to force content providers, including sports programmers, to deal only with them.").

[98] *See* Rehr, *supra* note 95, at 17. The Applicants anticipate that by combining their subscribers, "the merged company will be significantly more attractive to large national advertisers." *See Sirius Satellite Radio & XM Satellite Radio to Combine in Merger of Equals*, FD (FAIR DISCLOSURE) WIRE, Feb. 20, 2007 (Karmazin).

Commission should reject this proposal for the same reasons it rejected rate setting as a solution to competitive problems in *EchoStar/DirecTV*. A rate freeze on subscription prices would be inadequate because it does not address all of the other aspects of competition between the companies that would be lost, including competition on equipment pricing, equipment features, product quality (programming), customer service, and innovation. Nor does it address the possibility that, absent the merger, competition between the companies may lead to lower subscription prices in the future.

Even if a regulatory solution were feasible, it would not be desirable. As the Commission stated in *EchoStar/DirecTV, "*even if the ... pricing plan were likely to be an effective competitive safeguard, its implementation would not be consistent with the Communications Act or with our overall policy goals."[99] Like the parties in *EchoStar/DirecTV*,

> In essence, what Applicants propose is that we approve the replacement of viable facilities-based competition with regulation. This can hardly be said to be consistent with either the Communications Act or with contemporary regulatory policy and goals, all of which aim at replacing, wherever possible, the regulatory safeguards needed to ensure consumer welfare in communications markets served by a single provider, with free market competition, and particularly with *facilities-based* competition. Simply stated, the Applicants' proposed remedy is the antithesis of the 1996 Act's "pro-competitive, de-regulatory" policy direction.[100]

In sum, the best way for the Commission to protect consumers against the risk of market power is to maintain its policy of ensuring a modicum of intramodal competition in satellite DARS.

[99] *EchoStar/DirecTV Order*, 17 FCC Rcd at 20663, ¶ 282.
[100] *Id.*

Conclusion

The Commission should deny the transfer application because the Applicants have not demonstrated that competition in satellite DARS is no longer in the public interest. On the contrary, competition between the Applicants has provided, and will continue to provide, significant benefits to consumers, whereas the public interest benefits of the merger are dubious. As long as the firms are likely to be viable without the merger, and satellite radio is not a natural monopoly, there is no good reason for the Commission to abandon its policy of ensuring competition in the delivery of spectrum-based services in satellite DARS.

Respectfully submitted,

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