

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, EC 20554

In the Matter of)
)
Consolidated Application for Authority) **MB Docket No. 07-57**
To Transfer Control of XM Radio Inc.)
And Sirius Satellite Radio Inc.)

Petition to Deny of
Common Cause, Consumer Federation of America,
Consumers Union and Free Press

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SUMMARY

THIS MERGER TO MONOPOLY MUST BE REJECTED

The merging parties and their consultants urge regulators to abandon all their principles of merger review and include all forms of one- or two-way communications services and devices in a huge audio market. It is only by expanding the market definition in this way that the truly anticompetitive and anti-consumer nature of the proposed merger can be hidden. Merger reviews require a much more careful definition of the market than that. It requires close analysis of product and geographic market characteristics to establish the genuine substitutability between products. Defining the market incorrectly can lead the regulator to see more competition than there really is, which opens the door to classic abuses of market power. Approval of a merger based on an overly broad definition of the market is likely to result in rising prices, denial of choice, declining quality and slowing innovations.

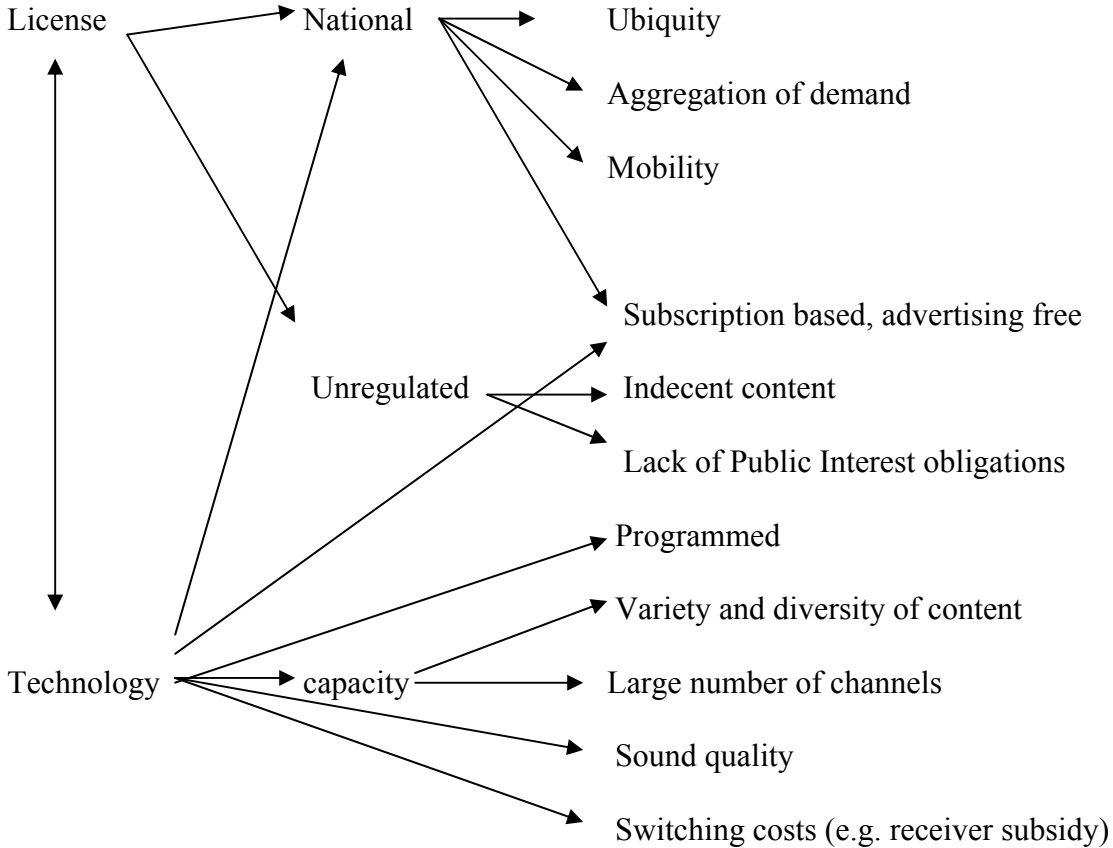
Merger analysis does not rest on theoretical discussions of what people might do in some distant future, but what people actually do today and are likely to do in the near and mid-term. In this petition to deny Common Cause, the Consumer Federation of America, Consumers Union and Free Press show that by the contemporary practical standards of merger review, the proposed merger between the only two satellite radio service providers will be a merger to monopoly in a clearly defined market segment. Based on both the supply-side behavior of the competitors and the demand-side behavior of consumers, the central competitive dynamic in the satellite radio market is head-to-head, intramodal competition between these two firms. Allowing the merger will eliminate that competitive dynamic and unleash market power to abuse consumers, artists and other input suppliers in the satellite radio market. In short, the prohibition on a merger between satellite service providers, which was included as a condition of the original licenses was sound policy when it was adopted and remains sound policy today.

Therefore, we urge the Federal Communications Commission to deny the transfer of licenses and preserve competition in the satellite radio market. The FCC should reject this merger not only because it denies consumers valuable competition, not only because it reduces diversity in a unique radio product market, but also because allowing the merger to proceed under a falsely overbroad definition of competition in the radio space would weaken the fundamental underpinning of the broad public interest oversight of broadcast media.

SATELLITE RADIO'S UNIQUE PRODUCT AND GEOGRAPHIC MARKET CHARACTERISTICS

Satellite radio possesses a unique bundle of characteristics that clearly distinguishes it from other audio entertainment products (see Exhibit ES-1). These characteristics reflect fundamental traits of the license and the technology used to exploit it. In turn, the business model reflects the opportunity provided by the technology and license. The license allows use of specific broadcast frequencies on a national, content unregulated basis. The technology to exploit this license is a digital, satellite broadcast to dedicated receivers. The business model is based on a subscription service.

Exhibit ES-1: The Distinguishing Characteristics of the Satellite Digital Radio Market



These legal, technical and economic characteristics create the opportunity for a nationwide, ubiquitous and mobile service that delivers many channels of high quality signals. With this national reach, satellite is able to provide highly specialized programming to audiences it can aggregate nationwide. Because it is unregulated, it can deliver “naughty” content, which is banned on other broadcast outlets, and it is not subject to the public interest obligations of other broadcast outlets. The subscription model enables satellite to be advertiser free and to subsidize the receiver cost to consumers.

INTERMODAL COMPETITION DOES NOT PROVIDE GOOD SUBSTITUTES

Satellite is certainly stealing audience from traditional terrestrial radio, but it is a one way competition. Terrestrial radio cannot effectively fight back (see Exhibit ES-2). It lacks the programming and market characteristics to hold or win back the customers who are attracted to satellite radio’s unique bundle of product characteristics. Terrestrial radio serves a small local market with advertiser supported, regulated content. It cannot aggregate audiences or match the quantity, quality, mobility and advertiser-free, naughty content that satellite provides. It is a different product with a different geographic market.

Digital Terrestrial radio (HD radio) solves a couple of the problems of terrestrial radio, but leaves most of the disadvantages of terrestrial radio in place. It is still capacity constrained

and limited to a small market. It must use advertising to support itself and has no subscriber base to subsidize receivers, which means switching costs are high.

Exhibit ES-2: Characteristics That Reduce the Substitutability between Satellite Radio and Alternative Audio Products

DISTINGUISHING CHARACTERISTICS	ALTERNATIVES			
	Terrestrial Radio Analog	HD	iPods & Other Storage Devices	Internet
Coverage				
Ubiquity (aggregation)	X	X		X
Mobility	X	X	x	x
Content				
Indecency	X	X		
Diversity/variety Programmed	X	X	X	x
Economic				
Advertiser free	X	X		X
License barrier to entry	X	X		
Switching costs		x	x	x
Quality	X			x

Capital ‘X’ indicates a permanent factor reducing substitutability; lower case ‘x’ indicates a factor that reduces substitutability in the time horizon for antitrust merger analysis, which might be overcome in the long term.

iPods and other content storage devices require consumers to access, choose, and download individual selections; they do not provide programmed services. Though they have substantial capacity, the capacity pales by comparison to that of satellite radio. It may seem odd to suggest that iPods and similar devices have limited content variety and diversity, since the consumer can download anything, but the consumer must find and download the content, which, in important cases, requires that the content is in the library for which the service provider has contracted for the right to download. It costs \$1,000 to put 1000 songs on an iPod, plus a hardware cost of \$250. The total cost is equal to eight years of satellite service.

Internet radio suffers many of the same problems as terrestrial radio. Much Internet radio is just a redistribution platform for terrestrial radio, which does not break the fundamental constraints of terrestrial radio. The business model still rests on advertising targeted and content tailored to the local market for which the terrestrial station holds a license. To the extent that some content is geographically specific (i.e. a home town baseball team) Internet distribution may make it accessible to out-of-market listeners, but it is difficult for the distributor to monetize that broader audience. As a locally based advertising model, aggregation of demand is not possible. Thus, programming that requires a large national audience, will be beyond the scope of terrestrial radio rebroadcast over the Internet.

Internet radio that is not based on the output of terrestrial broadcast radio (e.g. music services offered by cellular carriers) suffers several problems. Its quality is questionable and its price is high. Even as a stationary alternative, the product is limited by the need for access

to broadband, wireless or wireline. Thus, it suffers from bandwidth constraints. Satellite radio, on the other hand, is available to every consumer. Internet radio doesn't come close to being a nationwide, mobile audio product. Truly mobile Internet radio remains far more expensive than satellite radio. Monthly subscription fees are four to six times as high and the hardware costs are substantial. Mobile Internet radio is not a comparably priced substitute for satellite. Both types of Internet radio also have yet to solve the problem of getting into automobiles, which is the primary market for satellite radio.

THE RAPID GROWTH OF THE SATELLITE RADIO MARKET

Reflecting its unique product characteristics, satellite subscriptions are growing at a rapid rate – 14 million in just 5 years. Subscription is expected to rise to as high as over 40 million within the next few of years. The fact that satellite radio will not drive terrestrial radio completely out of business is irrelevant to the antitrust and public interest analysis. Satellite radio is a substantial market that deserves the full protection of the antitrust laws and the Communications Act.

The dramatic growth of satellite radio demonstrates its unique characteristics. The fact that the industry experienced a price increase in this early phase of growing penetration, while growth in subscribers continue apace, reinforces the conclusion that it is a distinct market. iPod use has been growing dramatically, as have wireless, Internet services, but so too has satellite radio. Each of these platforms is growing a distinct market based on new technologies, but the technologies are simply not close substitutes for one another. Therefore, they are not in the properly defined satellite radio market and could not discipline the market power that a merged XM-Sirius would have in the satellite radio market.

It is well established anti-trust practice that a unique bundle of characteristics that define a small but distinct submarket merits protection from the creation of market power through merger. The Office Depot/Staples merger was rejected by the courts on just such grounds (“the Court finds that the unique combination of size, selection, depth and breadth of inventory offered by the superstores distinguishes them from other retailers.” At the time of the attempted merger, Staples and Office Depot accounted for less than 6 percent of total office supply sales, but they had carved out a market segment and the court rejected the merger. The Whole Foods/Wild Oats Markets merger was recently challenged in the context of a narrowly similarly defined market (as the Federal Trade Commission stated in its complaint “Premium and organic supermarkets offer a distinct set of products and services to a distinct groups of customers in a distinctive way, all of which significantly distinguish premium natural and organic supermarkets from conventional supermarkets and other retailer of food and grocery items.”) Satellite is a distinct set of products the serves a distinct group of customers in a distinctive way.

THE ANTI-COMPETITIVE EFFECTS OF THE MERGER

The claim that there is sufficient intermodal competition to protect consumers and the market from anticompetitive abuse is refuted not only by a careful analysis of the product and

geographic market of satellite; it is also refuted by the projected effects of the merger on the marketplace. Wall Street analysts measure the benefits of the merger, not primarily through back office savings, but through slashes in cost that indicate the primary competitive dynamic in the industry is head-to-head competition between the two satellite service providers. Thus, advertising budgets and programming budgets are projected to be slashed, because head-to-head competition is eliminated. Deals with auto manufacturers or retailers to distribute receivers will become much sweeter for the merged satellite company because there will not be two companies to play off against each other. While the duopoly has not been very consumer-friendly – imposing a price increase, refusing to engage in penetration friendly pricing or unbundling of service and refusing to market an interoperable receiver – a monopoly is not the solution. Wall Street believes the number of channels of content available will be slashed. Future consumer-friendly pricing strategies that might be followed as the duopoly base of subscribers grows are less likely to be taken up by a monopoly.

This is what the Wall Street analysts say will happen and why they like the merger, but none of this would happen if intermodal competition were the central competitive arena for the satellite sector. Advertising would be maintained, since the intermodal threat has not changed. Talent would migrate to other platforms and not be forced to take a pay cut. Distributors of receivers would shift to other hardware if satellite threatened to change the terms of trade. In fact, the alternative platforms are not good substitutes on the supply-side, just as we have shown they are not good substitutes on the demand-side.

THE INDUSTRY'S FINANCIAL STATUS IS NO EXCUSE FOR AN ANTI-COMPETITIVE MERGER

The financial status of the industry is not a justification for the merger. The firms are not claiming that they will fail if the merger is not allowed to go forward and Wall Street analysts project near-term profitability for the industry. Satellite is a high fixed cost industry dependent upon building a mass subscription base to achieve profitability. Satellite is in the early phase and building its base rapidly toward a target audience that is more than adequate to sustain a profitable, duopoly sector business. Wall Street analysts believe that duopoly economics will support two satellite service providers without the merger. The merger would accelerate that march toward profitability, but at a high price to competition, consumers, artists and other input suppliers to the industry.

CONCLUSION

It is precisely such balancing judgments that regulators must make in determining whether a merger is in the public interest. In this case the conclusion is clear and straightforward. This is a merger to monopoly in a distinct product market that should not be allowed. Moreover, the merger does such harm to the competitive fabric of the industry that there can be no pretense that merger conditions could somehow repair the damage. Short term price protection for consumers will not compensate for long term pricing abuse, the loss of choice among competitors, or the elimination of competition as the driver of program development and service innovation.

I. INTRODUCTION

A PETITIONERS

Common Cause,¹ the Consumer Federation of America,² Consumers Union,³ and Free Press⁴ respectfully petition the Federal Communications Commission (FCC) to deny the transfer of control of XM Radio Inc. and Sirius Satellite Radio Inc.

B. THE TRANSFER REPRESENTS A MERGER TO MONOPOLY AND SHOULD BE DENIED

This petition presents the case against the merger of the only two satellite radio service providers, XM and SIRIUS.⁵ It demonstrates that the merger constitutes a merger to monopoly in a distinct product market. Such a merger violates both the antitrust laws and the 1934 Communications Act. By any interpretation of the antitrust laws a merger to monopoly

¹ Common Cause is a nonpartisan, nonprofit, advocacy organization founded in 1970 by John Gardner as a vehicle for citizens to make their voices heard in the political process and to hold their elected leaders accountable to the public interest. Now with nearly 300,000 members and supporters and 36 state organizations, common Cause remains committed to honest, open and accountable government, as well as encouraging citizen participation in democracy.

² The Consumer Federation of America is an advocacy, research, education and service organization established in 1968. CFA has as its members some 300 nonprofit organizations from throughout the nation with a combined membership exceeding 50 million people. As an advocacy group, CFA works to advance pro-consumer policy on a variety of issues before Congress, the White House, federal and state regulatory agencies, state legislatures, and the courts.

³ Consumers Union, the publisher of Consumer Reports®, is an independent, nonprofit testing and information organization serving only consumers. CU does advocacy work from four offices in New York, Washington, San Francisco, and Austin. CU's public policy staff addresses a broad range of telecommunications, media and other policy issues affecting consumers at the regional, national and international level. CU staff members frequently testify before Federal and state legislative and regulatory bodies and participate in rulemaking activities at the Commission and elsewhere.

⁴ Free Press is a national nonpartisan organization working to increase informed public participation in crucial media policy debates, and to generate policies that will produce a more competitive and public interest-oriented media system with a strong nonprofit and non-commercial sector.

⁵ This petition elaborates on the "Testimony of Mark Cooper on Behalf of the Consumer Federation of America, Consumers Union, and Free Press on Competition and the Future of Digital Music," before the *Antitrust Task Force of the House Judiciary Committee*, February 28, 2007; "Testimony of Gene Kimmelman on Behalf of Common Cause, Consumers Union, The Consumer Federation of America, Free Press, Media Access Project, and Prometheus Radio Project Regarding The XM-SIRIUS Merger: Monopoly or Competition from New Technologies," *Senate Committee on the Judiciary, Subcommittee on Antitrust, Competition and Consumer Rights*, March 20, 2007; and the "Statement of Gene Kimmelman on Behalf of Common Cause, Consumers Union, The Consumer Federation of America, Free Press, and Media Access Project Regarding The XM-SIRIUS and the Public Interest," *Senate Committee Commerce, Science and Transportation*, April 17, 2007

would be deemed to be anticompetitive, likely to result in higher prices, fewer choices, less service and less innovation. Under the Communications Act the merger would not serve the public interest, both because it is anticompetitive and because it reduces the diversity of ownership of media outlets.

The proposed merger of the only two satellite subscription radio companies should raise a red flag for both antitrust officials and communications regulators whose job is to promote competition and consumer choice in the marketplace. Not only were XM and Sirius prohibited from merging as a condition of getting their licenses to use the public airwaves to deliver their services,⁶ but also, as demonstrated by the enormous growth of satellite subscription radio service over just a few years, this service is, in fact, a distinct product and could develop into a vibrant competitive market absent the merger.⁷ We believe the companies who seek to merge so soon after they began competing and offering consumers innovative new services; so soon after they demonstrated that subscription radio is attractive to consumers and could be more so with consumer-friendly pricing and improved equipment interoperability; and in total disregard of the licensing conditions they accepted in order to use public resources, carry an enormous burden to demonstrate why public officials should abandon all normal rules associated with competitive markets and spectrum licensing to allow this merger.

⁶ *Establishment of Rules and Policies for the Digital Audio Radio Satellite Service in the 2310-2360 MHz Frequency Band*, Report and Order and Further Notice of Proposed Rulemaking, 12 FCC Rcd 5823 (para. 170).

⁷ In five years, satellite radio has garnered 13.6 million subscribers (*In the Matter of XM Satellite Radio Holdings Inc., Transferor and Sirius Satellite Radio Inc., Transferee, Consolidated Application for Authority to Transfer Control of XM Radio Inc and Sirius Satellite Radio Inc.*, MB Docket No. 07-57, March 20, 2007, pp. 3, 5. By 2010, Wall Street analysts project subscribership at between 25 million (David Bank, *XMRS SIRI Should Act on Urge to Merger... Now*, RBS Capital Market Corp. January 12, 2007) and 44 million (*Expert Declaration of J. Gregory Sidak Concerning the Competitive Consequences of the Proposed Merger of Sirius Satellite Radio, Inc. and XM Satellite Radio, Inc.*, March 16, 2007, pp. 45-46, citing estimates by Lehman Brothers and Bernstein))

XM and Sirius have not met that burden. Therefore, the Department of Justice (DOJ) and Federal Communications Commission (FCC) should reject this merger. The notion that imposing conditions can restore the competitive harm from a merger to monopoly is ludicrous.

C. THE DANGER OF AN OVERBROAD MARKET DEFINITION

Because a merger to monopoly is so obviously anathema to the antitrust laws, the merging parties claim that the authorities must view this merger in a much broader context. In this context, the merging parties claim that the merger does not create a monopoly: because the existence of cross-platform and intermodal competition means that *all* forms of distribution of audio content are interchangeable, even those that function merely as storage devices, and even those that provide two-way communications,⁸ and must be included in the market definition.⁹ They assert that national subscription radio service competes, directly and indirectly, with a variety of partial substitutes. Through this overbroad market definition, the merging parties claim that they represent two small fish in a large ocean, rather than the only two fish in a small but rapidly growing lake.

Such an overbroad definition would have disastrous consequence for consumers of satellite radio as well as both antitrust and public interest oversight in all media markets generally. By allowing the only two companies selling a specific type of media product to merge on the basis of erroneous claims of cross-platform or intermodal competition, the

⁸ Harold Furchtgott-Roth, *An Economic Review of the Proposed Merger of XM Sirius*, Ex parte filing, RE; Consolidated Application for Authority to Transfer Control of XM Radio Inc. and Sirius Satellite Radio Inc., MB Docket No. 07-57, June 27, 2007, p. 25.

⁹ “Testimony of Mr. Mel Karmazin, Chief Executive Officer, SIRIUS Satellite Radio Regarding Competition and the Future of Digital Music, before the *Antitrust Task Force of the House Judiciary Committee*, February 28, 2007.

fundamental basis on which all public interest regulation of broadcast media rests is destroyed.

If the product or geographic market is defined incorrectly, the analysis will assume there is competition where there is none and consumers will suffer mightily. In the media space, citizens will suffer as well because media play a vital role in democratic discourse. If the analysis assumes competition, where there is none, citizens will have fewer sources of news and information than assumed on which to base their political action.

In short, analysis under the antitrust laws, which focuses the attention of the Department of Justice (DOJ) (or the Federal Trade Commission [FTC]) on the economic impact of mergers on consumers and analysis under the public interest standard of the Communications Act, which focuses the attention of the Federal Communications Commission (FCC) on the impact of mergers on citizens, both require careful market definition and market structure analysis. In the case of the XM-SIRIUS merger, the market definition step takes on special importance because, if one concludes (incorrectly) that there is broad-based competition for satellite radio from other technologies, then the analytic, legal and constitutional basis for the public interest rules to protect consumers and citizens is significantly weakened.

Our concern about the danger of too broadly defining the product market is shared across the ideological spectrum. Gregory Sidak, former Deputy General Counsel of the FCC and Economist to the Council of Economic Advisers in the Executive Office of the President under the Bush Administration, argues:

"Broadcasting is more heavily regulated than other media. The FCC has justified that heavier regulation (and lower First Amendment protection) on the basis of four factors: the pervasiveness of broadcast speech, the scarcity of broadcast spectrum, the

governmental interest in preserving viewpoint diversity over the airwaves; and the traditional goal of fostering localism in broadcasting. If, however, all aurally delivered media are totally indistinguishable from each other – as XM and SIRIUS claim – and this merger is permitted to proceed on that basis, then it will have been approved on a rationale that would make the inferior First Amendment state of broadcasting untenable. All content and structural regulation of the broadcast industry would be constitutionally indefensible."

Scott Cleland, who describes himself as “a fervent and principled advocate of free markets and competition” reaches the same conclusion with respect to the antitrust laws:

"If the DOJ and the FCC endorse and enable an obvious government-created duopoly to become a monopoly, they would move the goal posts so far from existing precedent that they could not legally justify blocking any merger in the future..."

...If the DOJ or the FCC approved this obvious attempt of monopolization, it would be open season on Federal antitrust competition policy."¹⁰

The importance of understanding the broad implications of the theory that has been offered to justify this merger becomes even more apparent when we consider the position that of the National Association of Broadcasters (NAB) on the merger. While the NAB argues in *this* case that the market should not be defined to include cross-platform and intermodal competition, in the media ownership proceeding ongoing at the FCC, the NAB argues exactly the opposite — a position we have flatly rejected and which is not supported by the evidence.¹¹ If antitrust authorities accept XM-Sirius' overbroad definition of the mobile listening market, little foundation remains for rejecting NAB's overbroad definition of the media market generally.

¹⁰ Scott Cleland, “XM-SIRIUS merger is anti-competitive: The Emperor Has NO Clothes,” *Precursor Watch*, p.1

¹¹ See Comments of Consumer Federation of America, Consumers Union, and Free Press; *In the Matter of 2006 Quadrennial Regulatory Review – Review of the Commission’s Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996*, MB Docket No. 06-121, October 23, 2006 (hereafter, Media Ownership Comments).

This contradiction exists only in the warped world of the NAB. Careful market structure analysis, rigorously applied in all circumstances – media ownership,¹² merger review,¹³ and public interest oversight¹⁴ – as consumer advocates have applied shows that the overbroad definition of the market offered by XM-SIRIUS is simply wrong. We have shown in the media ownership proceeding that the traditional broadcast media remain distinct and dominant means of dissemination of information.¹⁵ In the cable horizontal limits proceeding, we have shown that cross-technology competition from DBS does not discipline cable pricing and only head-to-head competition is an effective discipline on cable.¹⁶ In this proceeding we show that satellite radio is distinct from broadcast and the other forms of audio entertainment.

“Open season” on the antitrust laws and on public interest regulation of broadcasting are dire consequences that we have pointed out in our congressional testimony.¹⁷ Fortunately, as both Sidak and Cleland conclude, the broad definition of the product and geographic market that XM-SIRIUS and their supporters¹⁸ use is so obviously flawed on both the

¹² *Id.*

¹³ Reply comments of Consumer Federation of America and Consumers Union in Opposition to the Transfer of Licenses, *Application of Adelphia Communications Corporation, Comcast Corporation and Time Warner Cable Inc., For Authority to Assign and/or Transfer Control of Various Licenses*, MM Docket No. 05-192, August 8, 2005; Comments of Consumer Federation of America, Consumers Union, Center for Digital Democracy and Media Access Project, *In the Matter of News Corporation/Fox Entertainment Group Merger with Hughes Electronics Corporation/DirceTV*, MB Docket No. 03-124, July 1, 2003.

¹⁴ Reply Comments of the Consumer Federation of America, Consumers Union, Free Press, Media Access Project and Communication Workers of America, *Implementation of the Cable Television Consumer Protection Act of 1992, Development of Competition and Diversity in Video Programming Distribution: Section 628(e) of the Communications Act: Sunset of Exclusive Contract Prohibition*, MB Docket No. 07-29, April 2007.

¹⁵ Consumer Federation et al., Media Ownership Comments.

¹⁶ Comments of Consumer Federation of America, Consumers Union and Free Press, *In the Matter of the Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules*, MM Docket No. 92-264, August 8, 2005.

¹⁷ Cooper, pp. 9-10; Kimmelman, pp. 11-12.

¹⁸ In congressional testimony, the only group to support the merger, aside from SIRIUS was Public Knowledge, see “Testimony of Gigi B. Sohn, President Public Knowledge, Satellite Radio Regarding Competition and the Future of Digital Music, before the *Antitrust Task Force of the House Judiciary Committee*, February 28, 2007; “Testimony of Gigi B. Sohn, President Public Knowledge Regarding The XM-

consumer and citizen dimensions that an unbiased analysis will easily conclude that the merger violates both the Sherman/Clayton Acts and the 1934 Communications Act. The facts are so clearly contrary to the claims of XM-SIRIUS and the defenders of the merger that the federal authorities should have little trouble seeing through the smokescreen and rejecting the merger.

D. OUTLINE

Section II defines the unique characteristics of satellite radio in conceptual terms.

Section III reviews the empirical evidence that supports the conceptual definitions.

Section IV presents the obvious conclusion that since this is a merger to monopoly in a distinct market, the merger should not be approved. It also explains why allowing the merger with conditions is not in the public interest.

II. WHY SATELLITE RADIO IS A SEPARATE PRODUCT

As public interest groups have pointed out in congressional testimony, “The product and geographic market characteristics of satellite radio are easily identifiable and quite distinct from other mobile and stationary audio products. It is national, mobile, programmed radio entertainment.”¹⁹

A. THE PURPOSE OF MERGER ANALYSIS

At the outset, it is important to understand what merger review attempts to accomplish and the role that market definition plays in achieving the goal. The purpose of market definition is to lay the groundwork for projection of the likely behaviors that will take place within the post-merger market. As David Balto,²⁰ a long time attorney at the Department of Justice and the FTC who counts among his credits litigation in opposition to mergers such as Staples/Office Depot, Time Warner/Turner and Time Warner/AOL, puts it the “critical issue in defining the market is what products constrain the pricing of satellite radio?”²¹ Sidak states the formal question as follow

Would a hypothetical monopoly provider of SDARS have the ability to increase price five percent above the “competitive rate,” for a nontransitory period of time (usually assumed to be two years) without losing a sufficient share of customers to alternative audio services such that the price increase would be rendered unprofitable... An antitrust market is defined as the narrowest group of products that would allow a hypothetical monopolist to profitably impose a “small-but-significant-and-nontransitory (SSNIP) – generally, a five percent increase above the competitive price.”²²

¹⁹ Cooper, p. 2; Kimmelman, p. 2.

²⁰ Testimony of David A. Balto regarding The XM-SIRIUS Merger: Monopoly of Competition from New Technologies, *Senate Committee on the Judiciary Subcommittee on Antitrust, Competition and Consumer Rights*, March 20, 2007, p. 1

²¹ *Id.*, p.

²² *Id.*, pp. 8-9.

The formal definition calls our attention to key considerations. The definition focuses on the narrowest groups of products. The price increase (5 percent) that might result need not be huge to cause concern. The time frame for the analysis is relatively short – two years. In other words, both the attention to the narrowest group of products and the short but nontransitory period of two years focuses antitrust merger analysis on what is in the market or could get to market quickly, not long-term hypothetical speculation about what could eventually be in the market.

Moreover, Balto points out that “The antitrust laws protect not only competition in terms of price but also competition in terms of service, choice and innovation. This is especially important in media mergers, where competition may be primarily in terms of product variety, product offerings, and other forms of nonprice competition.”²³ The latter point is particularly important in this case because many of the services that XM-SIRIUS and their supporters claim compete with satellite radio are free (advertiser supported). In a sense, there is primarily nonprice competition – for product differentiation and quality. However, as Sidak points out advertising does impose a cost on consumers – they hate to listen to it. On the other hand, as Sirius points out in its self-promotion, advertising affects the quality of the listening experience. Advertiser free is an important product characteristic.

B. SATELLITE DIGITAL AUDIO RADIO SERVICE IS A UNIQUE PRODUCT

1. Regulatory Differences

Sidak and Cleland, who agree that Satellite Digital Audio Services (SDARS), to use Sidak’s term, is a distinct audio product, emphasize the regulatory difference between satellite

²³ Id., p. 1

and broadcast radio, which give rise to important economic differences. Cleland briefly summarizes the fundamental differences as follows.

This is a clear government created market. XM and SIRIUS could not be in business without a government license of spectrum to create a national subscription based satellite service market...

[O]ver the air broadcast.. [is] also licensed by the FCC and could not exist or do business without a government license to do so. The government organized the over the air radio market in another era under a completely different business model. They got free local spectrum licenses, for an advertising model and had public obligations of carrying public interest messages and not transmitting indecent programming.²⁴

Four economic characteristics emerge from this observation.

- Licensing is a barrier to entry.
- The distinction between advertiser supported and subscription-based business models flows from the license.
- The geographic scope of the licenses is different. One is national; the other is local, which leads to the production of very different content on the two services.
- The nature of the license opens the door to market segmentation based on the type of content that is allowed under the license; satellite has free reign to air indecent content.

Sidak emphasizes the last point in the Cleland quote above. He launches his description of the satellite radio product with the observation that “the FCC indecency standards have created an economic incentive for a market segmentation to develop between advertiser-based programming and subscriber-based programming.”²⁵ Not only did he begin his description of the nature of the service with the indecency point, he devoted ten pages to it, one sixth of his analysis.

Sidak also identifies other distinguishing characteristics by citing Sirius’ own press releases that point out the characteristics that SIRIUS has, which alternatives do not. “This

²⁴ Cleland, p. 2

²⁵ Sidak, p. 15.

press release emphasizes the absence of commercials, ubiquity and large numbers of channels as the characteristics that distinguish SDARS (satellite, digital audio radio services) from terrestrial radio broadcasts.”²⁶ Thus Sidak offers three additional characteristic to the list offered by Cleland, or adds importance nuances to them. Satellite radio is

- ubiquitous (i.e. mobile)
- commercial free, and
- has a large number of channels.

2. Economic Differences

Conservatives are not the only ones to conclude that satellite radio is a distinct product. David Balto concludes that

*this merger poses the potential for significant anticompetitive harm in the satellite radio market by combining XM and SIRIUS, the only two providers of satellite radio. This merger would lead to higher prices, less service, less choice and less innovation, and should not be approved by the Antitrust Division of the Department of Justice or the Federal Communications Commission regardless of any “regulatory promises” offered by the parties.*²⁷

Rather than launch his argument from the regulatory difference, David Balto examines the economic characteristics of the product that satellite radio companies sell. In testimony before the Senate Judiciary Committee Balto cautions that “[s]imply because certain products seem similar to the products being offered by the merging parties does not mean they are in the same relevant product market.”²⁸

Balto also uses the self-definition of Sirius radio as a good place to start in understanding the unique product that satellite radio offers. Balto points out that the SIRIUS web site promotes its product as follows:

²⁶ Sidak, p. 26.

²⁷ Balto, p. 1

²⁸ Balto, p. 1

The biggest difference is that SIRIUS has 100% commercial-free music free channels. What this means for you is that we offer you music the way it should be and the way the artist intended it: without a single commercial interruption. Our music programming also has a breadth and depth of programming basically unavailable on regular radio. We play songs that you know and love, and many songs that we know you will love when you hear them for the first time. We also have hundreds of exclusive live interviews and performances you won't hear anywhere else and produce many interesting and engaging live talk shows in our national broadcast studios.²⁹

The key characteristics that Sirius uses to self-define its unique product in this promotion are

- Commercial free,
- Depth and breadth of content,
- Old and new programmed content,
- Non-music content, and
- National broadcasting.

Balto elaborates on the economic significance of these characteristics by defining five unique product traits of the satellite offering:

Aggregating Demand: *Satellite radio has the breadth and depth of programming because it can aggregate demand unlike other forms of audio entertainment...*

Ubiquitous service: *Satellite radio follows you everywhere. Satellite radio travels with the person, assuring the same level of sound quality or content wherever you are...*

Product variety: *Satellite radio offers a far greater number of stations than terrestrial radio or even HD radio...*

Diverse formulated programming: *Satellite radio does not just broadcast various forms of entertainment. Rather satellite radio formats program content to provide diversity, introduce listeners to new music and new forms of entertainment...*

²⁹ Balto, p. 3

Unregulated content: *The content of satellite radio is not regulated. This permits a wide variety of product offerings to satisfy consumer demand; satellite radio is not regulated or constricted by the rules of the FCC.*³⁰

Thus, the first step is to define the market carefully. Balto concludes that satellite radio is a distinct product

*based on these product characteristics – aggregating demand, ubiquitous service, product variety, diverse formulated programming, and unregulated content – there are strong reasons to believe that the appropriate relevant market is satellite radio... Although certain parts of the satellite radio package can be acquired through other audio outlets, including web-based radio, digital media services, and terrestrial radio, no other service offers the complete variety of audio entertainment options offered by satellite radio.*³¹

Balto compares the XM-SIRIUS merger to the proposed Staple/Office Depot merger, which was blocked by the courts, reminding the Senators that

*the Court effectively concluded that there was an office supply superstore market because what Staple and Office Depot offered was the opportunity to engage in a one-stop shopping experience where a wide variety of office supply needs could be purchased. It was not just the products being offered, but it was the shopping experience that defined the market.*³²

C. ANTITRUST, REGULATION AND ECONOMIC FACTORS AND PRODUCT DEFINITION

1. Antitrust Precedent

Balto's launch point in economic characteristics and the Staples/Office Depot merger serves to remind us that in the antitrust scrutiny of most industries, the origin of the product characteristics would not be an issue. As in the Staples/Office Depot example, the fact that the merging parties had come to occupy a unique product space through purely autonomous business model development would not affect the antitrust analysis directly, except perhaps in

³⁰ Balto, p. 3

³¹ Balto, p. 4.

³² Balto, p. 5.

assessing whether there were barriers to entry. The fact that Office Depot and Staples had chosen the office superstore model independently and without any government assistance and come to dominate that market segment did not prevent the court from finding that the merger between two dominant firms in the market segment would have anticompetitive effects on that market. A market does not have to be “government-created,” to use Cleland's terms, to demand close antitrust scrutiny. A merger to monopoly does not have to rest on a government license to violate the antitrust laws.

Balto’s explication of antitrust cases places the XM-SIRIUS merger in proper perspective. The analogy between the office superstore and the satellite super service delivering a smorgasbord of services fits perfectly, as Balto pointed out quoting from the Court; “the Court finds that the unique combination of size, selection, depth and breadth of inventory offered by the superstores distinguishes them from other retailers.”³³ At the time of the attempted merger, Staples and Office Depot accounted for less than 6 percent of total office supply sales, but they had carved out a market segment and the court rejected the merger.³⁴

Balto cites other failed attempts to create an overbroad definition of the relevant market to justify a merger. Thus, the broad definition of all aurally transmitted content, which XM-Sirius and their supporters claim as the relevant market, is akin to the effort of Coca Cola to purchase Dr. Pepper, which rested on a failed effort to convince the court to include all liquid refreshment in a “share of stomach” calculation of the total market. In such a calculation “the parties there described the market in terms of ‘share of stomach’ and suggested that Coke’s and Dr. Pepper’s share of stomach was relatively small compared to all

³³ Balto, p. 5.

³⁴ Balto, p. 4.

other liquid refreshment.”³⁵ As Balto points out the Coke-Dr. Pepper merger has another similarity to the XM-Sirius merger. One of the competitors for “share of stomach” that the merging parties tried to include in the market was water, which is ‘free.’ However, “even though water was obviously free, it did not serve to constrain the potential exercise of market power by a combined Coke and Dr. Pepper.”³⁶ A final case cited by Balto that bears on the current merger involved challenges to a merger between movie theater chains. “Again there were numerous alternatives to actually going to the movies if one wanted to watch a full-features film, including free TV and movie rentals, but these were not in the relevant market because they were qualitatively different and these alternatives were unable to restrain the prices of watching a film at a movie theatre.”³⁷

Thus, general antitrust practice looks carefully at markets to ascertain the essential characteristics of the products and the ability of other products to constrain price increases, without any necessary reference to government licenses. In several of the examples a ‘free’ alternative is available, but not considered a sufficiently close substitute to discipline pricing abuse. Moreover, these examples are not old antitrust practice; they are quite recent (Staples/Office Depot - 1995; Coke/Dr. Pepper - 1997; Marquee Holdings –2005). Indeed, the Federal Trade Commission has recently challenged the Whole Foods acquisition of Wild Oats Inc., invoking a definition of a carefully defined market,

Premium and organic supermarkets offer a distinct set of products and services to a distinct groups of customers in a distinctive way, all of which significantly

³⁵ Balto, p. 6.

³⁶ Balto, p. 6.

³⁷ Balto, p. 7.

distinguish premium natural and organic supermarkets from conventional supermarkets and other retailer of food and grocery items.³⁸

Satellite is a distinct set of products that serves a distinct group of customers in a distinctive way.

2. The Added Impact of Licenses

In the case of satellite radio, the fact that a government license stands behind the business model does add another layer of consideration, for that license helps to define the unique product market in at least two aspects. First, it is a national license, creating the possibility to aggregate demand. Second, the licensee is unregulated with respect to content, in contrast to other licensees who are. Thus, not only is the license a barrier to entry, but also it is a cornerstone of the market segmentation that helps to differentiate satellite radio from traditional broadcast radio, as well as other forms of audio content. The ability to reach a national audience with diverse, unregulated programming flows from the nature of the underlying license.

The technology used to exploit this opportunity also gives satellite radio unique characteristics from the point of view of market definition. To exploit a national license one deploys a digital technology that delivers high capacity and high quality. This requires not only new transmitting equipment but also new, dedicated receiving equipment. Consumer switching costs – the cost of deploying the receivers – become an important factor in determining whether consumers will switch services.

The license and the opportunity to reach this type of audience make the subscription/advertising free model possible. Satellite radio has become a national, mobile,

³⁸ Federal Trade Commission, “Complaint” *In the Matter of Whole Foods Market, Inc and Wild Oats Markets, Inc*, Docket No. 9324, June 27, 2007.

advertiser free, super service stocked with diverse, indecent unregulated content because the license and the technology made it possible and consumers are willing to pay for this unique product, so much so that demand has been growing by leaps and bounds (40 percent last year) in spite of rising prices.

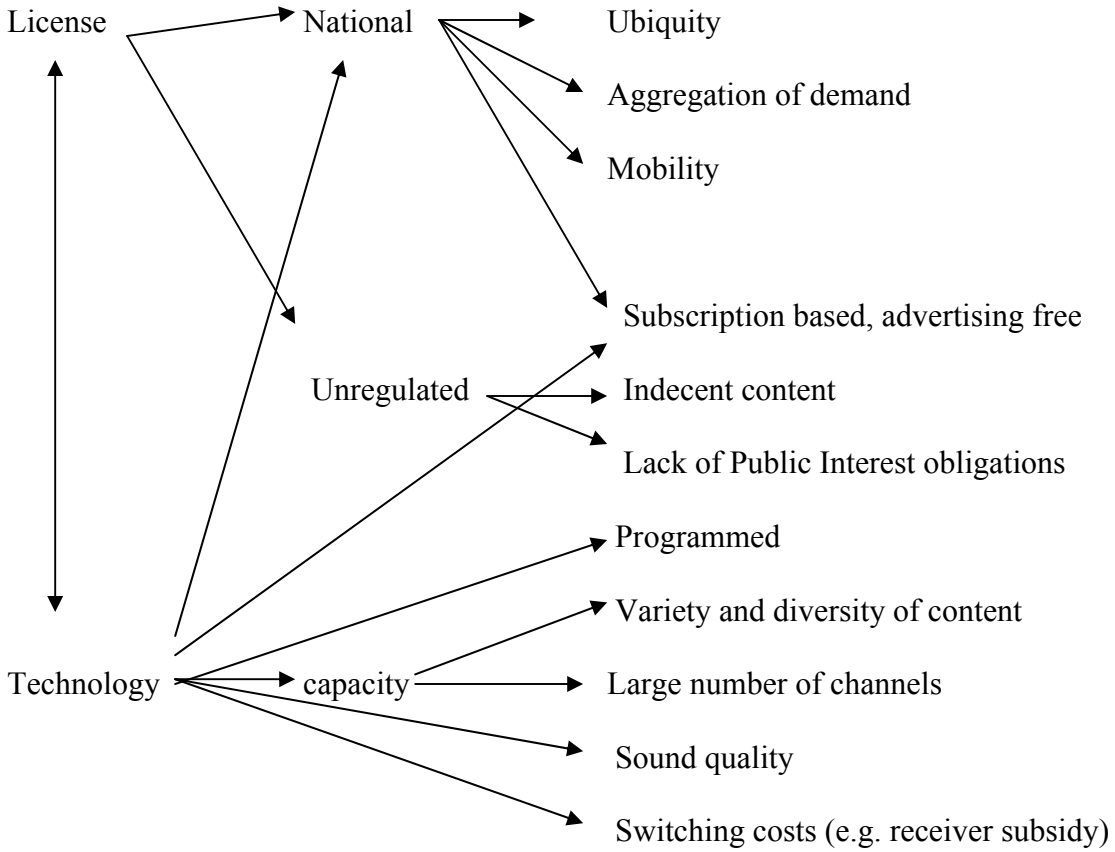
Not only does the license have a tremendous impact on the nature of the product delivered, it stands as an absolute barrier to entry into this unique product market. There were only two such licenses issued. No direct entry, no increase in head-to-head satellite competition is likely. It might be possible for a different distribution technology to be the basis for a national, mobile, advertising free content unregulated programmed audio service, but none exists today and the alternatives put forward by XM-SIRIUS and their supporters simply do not have the characteristics of satellite radio. The licenses give a unique advantage to their holders in this market segment.

D. CONCLUSION

Thus, although each of these analysts lists a set of characteristics that distinguish satellite radio some emphasizing the regulatory roots of the industry, it is important to see how the economics and the regulation go together (see Exhibit 1). Once the tight nexus of the product characteristics is explicated, it becomes more apparent that the alternatives put forward by XM-Sirius and their supporters as competitors are simply not very good substitutes. It is also easy to see why no directly competitive alternatives based on different technologies have come into existence, as discussed in the next section. The next section discusses how these characteristics distinguish satellite from each of the services that supporters of the merger have put forward as competitors.

Exhibit 1:

The Distinguishing Characteristics of the Satellite Digital Radio Market



III. ALTERNATIVE AUDIO PRODUCTS ARE WEAK SUBSTITUTES FOR SATELLITE RADIO'S UNIQUE PRODUCT

A. OVERVIEW OF DISTINGUISHING PRODUCT CHARACTERISTICS

Given the economic characteristics of satellite radio and the framework of merger analysis discussed above, it is readily apparent not only that satellite radio is a distinct market, but that the alternative put forward by XM-SIRIUS and their supporters are not close enough substitutes to discipline the market power that would result from the merger. Exhibit 2 summarizes the key characteristics that distinguish satellite radio from the alternative audio products that XM-SIRIUS and their supporters have put forward as competitors to satellite.

**Exhibit 2:
Characteristics That Reduce the Substitutability between Satellite Radio and
Alternative Audio Products**

DISTINGUISHING CHARACTERISTICS	ALTERNATIVES			
	Terrestrial Radio Analog	HD	iPods & Other Storage Devices	Internet
Coverage				
Ubiquity (aggregation)	X	X		X
Mobility	X	X	x	x
Content				
Indecency	X	X		
Diversity/variety	X	X	X	x
Programmed			X	
Economic				
Advertiser free	X	X		X
License barrier to entry	X	X		
Switching costs		x	x	x
Quality	X			x

Capital 'X' indicates a permanent factor reducing substitutability; lower case 'x' indicates a factor that reduces substitutability in the time horizon for antitrust merger analysis, which might be overcome in the long term.

The nine key characteristics of satellite clearly make it a unique product. Taken singly or together, the alternatives do not come close to delivering a product that matches satellite. In the case of Internet-based alternatives (iPods and Internet radio) some of the factors that reduce their substitutability may not be permanent. However, they are not likely to change significantly in the time frame that is relevant for the antitrust merger review. Moreover, even if the problems were solved, there would still be substantial differences rendering them poor substitutes.

B. TERRESTRIAL BROADCAST RADIO

1. Traditional Analog Radio

The bulk of the discussion in this paper, in the analyses noted above, and in the Congressional testimony focuses on terrestrial radio. In part this reflects the fact that XM-SIRIUS directs the attention there because they claim this as their primary competition. In part antitrust analysis naturally focuses there because it is the established product from which satellite radio has distinguished itself.

Differences in federal licensing requirements demonstrate the clear distinction between satellite radio and free over-the-air radio. First, the different restrictions on the licenses demonstrate the market differences. Broadcast licenses require the service to be offered free of charge, requiring advertiser support. Local radio stations adjust their content to the audiences that the advertisers want to reach. Satellite radio licenses allow the licensee to

support the service through subscription fees, offering largely commercial-free radio — a distinction that Sirius, in particular, widely promotes.³⁹

Second, satellite radio travels with the listeners no matter where they are, operating in a national market. But terrestrial radio is a local product; stations vanish as the listener crosses market boundaries.

Third, broadcast licenses are subject to public interest obligations, while satellite services are not. As Greg Sidak noted, the licensing differences allow for different market segmentation between the two services.⁴⁰ Terrestrial radio will never be able to provide some of the programming currently offered on satellite not only because of content restrictions,⁴¹ but also because its licensing requirements limit it to a small geographic market, preventing it from aggregating demand for the types of specialized programming offered on satellite radio. Thus programming on satellite radio tends to be more specialized and more diverse than that of terrestrial radio.

The other regulatory and economic characteristics that distinguish satellite from terrestrial radio reinforce this basic difference. Satellite can develop a much wider array of

³⁹ Sirius states "The biggest difference is that SIRIUS has 100% commercial-free music free channels. What this means for you is that we offer you music the way it should be and the way the artist intended it: without a single commercial interruption. Our music programming also has a breadth and depth of programming basically unavailable on regular radio. We play songs that you know and love, and many songs that we know you will love when you hear them for the first time. We also have hundreds of exclusive live interviews and performances you won't hear anywhere else and produce many interesting and engaging live talk shows in our national broadcast studios." XM promotes on its website the availability of 69 commercial-free music channels.

⁴⁰ Expert Declaration of J. Gregory Sidak Concerning the Competitive Consequences of the Proposed Merger of SIRIUS Satellite Radio, Inc. and XM Satellite Radio, Inc., March 16, 2007, p.6

⁴¹ For example, XM currently offers Laugh Attack, promoted as "Uncensored Comedy;" and Opie and Anthony, two radio personalities whose former on-air performances resulted in FCC fines. Both XM and Sirius offer Playboy Radio, and adult entertainment premium channel. Sirius offers Raw Dog Comedy, which provides uncensored comedy; Maxim Radio, promoted as "Girls, comedy, sports, music: Maxim Radio is the best thing to happen to men... since women!;" and Howard Stern, the shock jock whose performances have resulted in FCC fines. Moreover, both services offer out of market sporting events unavailable on terrestrial radio: Sirius offers the NFL channel and XM offers the MLB channel.

content because it reaches a much larger audience and this ability to develop special programming is reinforced dramatically by its ability to program without indecency constraints. Thus, it has become the home to an array of ‘naughty’ programs.

Thus the typical over-the-air radio station covers a small geographic area. It raises revenues by selling advertising that is geared to that area. Advertisers know what area the radio station reaches and adjust their spending accordingly. The radio station adjusts its content to the audience that the advertisers want to reach and the radio station can reach. The result is a very small, narrow range of content/output per radio station. Compared to satellite radio, terrestrial radio is a single channel directed at a miniscule audience. Even in the most densely populated area, a radio station can reach, at most, a few million people and sell advertising on that basis. Each of the satellite service providers and reach hundreds of millions of people with over a hundred channels.

Sidak presents a lengthy analysis demonstrating that ‘naughty’ programming is popular and different. The most celebrated example is the huge sum of money paid by Sirius to Howard Stern. At the House hearing on the merger, Mel Karmazan, CEO of Sirius, claimed that this was purely a money thing for Stern. If terrestrial radio had been able to outbid him, Stern would still be on over-the-air radio. That statement is incorrect for both the economic and regulatory reasons we have discussed above. Terrestrial radio stations do not reach a large enough market to aggregate the demand for Mr. Stern’s brand of ‘naughty.’ More importantly, and Mr. Stern made this clear, regulated terrestrial radio is not hospitable to Mr. Stern’s brand of ‘naughty.’ He did not feel welcome because he had to look over his shoulder and watch his mouth.

Sidak conducts a second exercise to show the dramatic difference between satellite and terrestrial radio. Antitrust authorities will typically look at the individual producers in a specific geographic market and ask whether they could expand their output in response to a small but significant price increase. If they can do so quickly, then any price increase would be short-lived (i.e. transitory). It is quite clear that individual radio stations do not have the capacity to expand the number of formats they deliver. They are bound by their technology, their licenses, and the resulting business model. Sidak asks, contrary to traditional antitrust analysis, about the aggregate capacity in the market. Examining the total terrestrial capacity compared to the channel capacity of satellite, he finds that satellite alone carries many more channels than are available over-the air in even the largest radio markets. In New York City there are only 47 terrestrial radio stations (although the typical consumer probably is reached by only half of those). XM and Sirius deliver 300 channels into that market (although some consumers may not be able to get both because of the satellite positioning).

If one conducts the analysis of market structure on the basis of channel capacity because of the differences in technology, one concludes that this merger is horribly anticompetitive. Sidak makes it clear that, given the market definition, this approach is incorrect and we will not elaborate on it here. The proper analysis rests on the proper market definition. Terrestrial radio is a local product. Satellite radio is a national product. They have different business models and different types of output for regulatory and economic reasons.

Satellite is certainly stealing audience from traditional terrestrial radio, but it is a one way competition. Terrestrial radio cannot effectively fight back. It lacks the programming

and market characteristics to hold or win back the customers who are attracted to satellite radio's unique bundle of product characteristics.

2. HD Radio

In several important ways HD radio is an extension of terrestrial radio. It may solve the quality problem of terrestrial radio, but it carries the other weaknesses (as a competitor to satellite) forward, while it picks up other infirmities. HD radio is still broadcast to a small local market. It is still subject to content regulation. It also has substantial equipment costs, which traditional terrestrial radio does not. It may expand the capacity of an individual broadcaster a little, but the capacity of local radio still is minuscule compared to satellite.

Bernstein Research, the Wall Street firm that follows the satellite radio industry most closely, provided a detailed explanation of why “digital terrestrial radio poses little threat to the growth in Satellite radio subscriptions.”⁴² The analysis recognizes that HD radio has some characteristics that bring it closer to satellite radio,⁴³ but concludes that

[d]igital radio cannot address four key factors that drive consumer adoptions of satellite radio:

- (1) Commercial free music;
- (2) A large range of channels in a variety of formats (120-150 channels offered in every market);
- (3) Exclusive programming such as play-by-play NFL and MLB games, Martha Stewart and Howard Stern; and
- (4) Satellite radio's distribution advantage at the auto OEMs.⁴⁴

⁴² Bernstein Research, *Satellite Radio: Limitations of Digital Radio Suggest Impact on Satellite Radio Will Likely be Small* (December 8, 2005), p. 1.

⁴³ Bernstein Research, December 8, 2005, p. 2, “Digital radio is one way for terrestrial radio to attack the core advantages of satellite radio; better sound quality; delivery of advanced services (such as displaying artist and song titles information); greater variety of formats and channels; and commercial-free music (likely only in the initial phases of the digital radio rollout).”

⁴⁴ Bernstein Research, December 8, 2005, p. 1.

Bernstein Research further considers the business model and switching cost barriers to effective head-to-head competition between HD and satellite radio.

The most significant gating factor in the adoption of digital terrestrial radio is that consumers must buy new digital radios in order to be able to receive the new digital radio signals... The impact of digital radio will be greatly diminished because the audience size is limited by how many people have digital radios...

Car HD radio products have been introduced... However, digital radio sets are now only starting to reach consumer-friendly price points. They are still expensive – mostly in the range of \$250-600 – and again lack an economic model for a hardware subsidy.⁴⁵

The fundamentally different business models, tied to fact that one product is a local, advertiser supported product and the other is a national subscription product, impact more than the ability to subsidize receivers. They dictate that different services will be delivered to the public.

Although currently the new multicast stations are commercial free, this is obviously not sustainable in the long term; “free” does not help a radio station recover the cost of going digital, nor does it help in producing the stations... In fact to the extent that the new channels draw listenership away from the primary stations, it will reduce the amount of advertising revenue that can be earned by the primary station. To make up for this, advertising will be introduced to the multicast stations.

It has been suggested that the new digital technology could be used to launch new subscription services. In practice, this could prove quite difficult; it would require whole new systems to be developed and implemented, including encryption of radio signals; decryption technology at the radio; account billing and payment systems and customer services. The cost is likely to be prohibitive for any given radio station, or even for a whole local market, given the limited potential target market.

It is questionable whether a new niche channel in a single market can attract enough listeners to earn enough advertising revenue to cover these costs and make the channel viable.

⁴⁵ Bernstein Research, December 8, 2005, pp. 2-3.

This compares with satellite radio, which can spread the cost of a channel over a national audience, and also has the support of subscription revenues.

The extra stations may also further fragment an already fragmented radio listening market, potentially deterring advertisers. Radio audiences in a given local market would be spread between perhaps a couple of dozen small niche stations, few of which may offer a large enough group of listeners to constitute a worthwhile ad buy.

The number of extra streams will depend on the format; perhaps 2-3 additional music channels, 3-4 talk channels, and up to 8 streams for very low bit rate formats such as traffic and weather.⁴⁶

It is this type of careful analysis of products and markets that the advocates of the merger fail to provide. It is this type of analysis of product and geographic markets characteristics that is the backbone of merger review.

C. IPODS AND OTHER STORAGE DEVICES

iPods and other content storage devices require consumers to access, choose, and download individual selections; they do not provide programmed services. Though they have substantial capacity, the capacity pales by comparison to that of satellite radio. It may seem odd to suggest that I-Pods and similar devices have limited content variety and diversity, since the consumer can download anything, but the consumer must find and download the content, which, in important cases, requires that the content is in the library for which the service provider has contracted for the right to download.

As Mr. Balto demonstrated, the cost of that limited capacity is expensive: "an iPod with 1,000 songs would have approximately \$1,000 worth of content or approximately six and a half years of the cost of an XM monthly service."⁴⁷ The dollar cost is in addition to the fact

⁴⁶ Bernstein Research, December 8, 2005, pp. 3-5.

⁴⁷ Balto, p. 6.

that the iPod requires affirmative consumer action to access music; it lacks the programmed characteristics of satellite radio where music and information is pushed out to the listeners, exposing them to new content, at the flip of a switch.

Thus, while the iPod certainly has the convenience of playing songs you know about and like, the iPod would “not have the selection of XM, not the sophistication of the DJ mixes the radio at XM provides, not the new music that XM can introduce to the listener. The iPod cannot perform the important function of educating listeners by introducing them to new music and forms of entertainment.”⁴⁸

Moreover, the diversity of programming and the capacity of the system which has enabled satellite radio to develop narrowly targeted niche programming lower the cost of learning about new music. Listeners can go to the genre they're interested in, programmed by a DJ who reflects their tastes and hear an array of old and new content without commercial interruption. Thus, satellite radio becomes a complement for the iPod (assuming the iPod service provider has the desired song in its library). Having heard a new song on Sirius's eclectic channel "Sirius Disorder," the listener can download it to his iPod or MP3 player.

Moreover, today, most MP3 players are used for listening to music. They do not generally deliver non-musical content programmed live: news, sports, talk and other entertainment, which constitutes a substantial part of the programming content, 40% in the case of SIRIUS. In addition, content from satellite radio is delivered in real time; the listener does not download then listen to it later whenever they want as with iPods and other MP3 players. Finally, the mere fact that both MP3 players are mobile is not sufficient for these products to be substitutes. The merging parties could not with a straight face suggest that

⁴⁸ *Id.*, .p. 6.

built-in CD players function as a substitute: the iPod is a similar device, only with greater storage capacity: it allows consumers to take music and other content they have already purchased and play it in their cars.

Bernstein Research turned a careful eye on the Internet based alternatives for delivering music because “[i]nvestor’s third major concern appears to be inter-modal competition, or – more colorfully – death by iPod (or, alternatively, “death by cellphone”).⁴⁹ Bernstein Research concludes that “the cross-elasticity between the two platforms is likely overstated, and satellite has a number of advantages over iPods in cars. In our view, the two are likely to be more complementary than is generally believed.”⁵⁰ Bernstein Research notes that there are fundamental differences in the products that set them apart.

Satellite is likely to prove preferable to those consumers who do not want or have time regularly to put new songs onto an iPod, or to maintain and create playlists (recall that most cars come with CD players, but people still listen to AM and FM radio). And it’s constantly refreshing the programming, offers a way to sample new music that can be *added* to an iPod. There’s also a potentially large economic benefit to end-users associated with satellite radio’s ability to store songs in a personal library (now a feature of portable units, but undoubtedly coming to cars soon). All of these are likely to be especially important considerations to consumer who spend large amounts of time in their cars commuting every day.

Apart from music, there is also other programming that attracts consumers to subscribe to satellite radio, including exclusive programming like Howard Stern, play-by-play baseball and football, and some 70 channels of nonmusic programming, including local news and weather, Martha Stewart and (in September) Oprah Winfrey.

With more cars coming with attachments for iPods, there will undoubtedly be some people who decide to just use their iPods in their cars, and decide they

⁴⁹ Bernstein Research, *Satellite Radio 1Q Preview: All Eyes are on Conversion Rates, SAC, and iPods* (April 25, 2006, p. 5.

⁵⁰ Bernstein Research, April 25, 2006, p. 5.

don't need satellite radio. But there is a big gulf between having iPod integration "available" and having satellite radio already factory installed.⁵¹

D. INTERNET RADIO

Internet radio suffers many of the same problems as terrestrial radio. Much Internet radio is just a redistribution platform for terrestrial radio, which does not break the fundamental constraints of terrestrial radio. The business model still rests on advertising targeted and content tailored to the local market for which the terrestrial station holds a license. To the extent that some content is geographically specific (i.e. a home town baseball team) Internet distribution may make it accessible to out-of-market listeners, but it is difficult for the distributor to monetize that broader audience. As a locally based advertising model, aggregation of demand is not possible. Thus, programming that requires a large national audience, will be beyond the scope of terrestrial radio rebroadcast over the Internet.

Internet radio that is not based on the output of terrestrial broadcast radio (e.g. music services offered by cellular carriers) suffers several problems. Its quality is questionable and its price is high. And both types of Internet radio also have yet to solve the problem of getting into automobiles, which is the primary market for satellite radio. Even as a stationary alternative, the product is limited by the need for access to broadband, wireless or wireline. Thus, it suffers from bandwidth constraints. Satellite radio, on the other hand, is available to every consumer. Internet radio doesn't come close to being a nationwide, mobile audio product.

⁵¹ Bernstein Research, Satellite Radio: *What Has Change (other than Sentiment)?* May 12, 2006, p. 4.

As demonstrated above, the relevant product market for this merger is satellite radio itself. Thus, despite their contentions, the only alternative for XM is Sirius Radio; the only alternative for Sirius is XM. The merger is a merger to monopoly — a type of merger that is antithetical to the competition laws, and perhaps the worst offense against the basic principle that competition is the consumer’s best friend. There is no circumstance more disturbing from the point of view of the antitrust laws and the Communications Act than a merger within a distinct product market that takes the number of competitors from two to one. That will be the result if regulatory and anti-trust authorities swallow the erroneous, overbroad market definition proposed by Sirius and XM.

E. MARKET LEVEL INDICATORS THAT SATELLITE RADIO IS A DISTINCT MARKET

Macro level data suggest that these alternatives are not sufficiently direct competition to discipline satellite radio. In spite of the existence and growth of these alternatives, satellite radio has exhibited strong growth and increasing prices.⁵² The growth in subscribership and revenues for Sirius and XM, based on their SEC 10-5 filings, reinforce the uniqueness of satellite radio’s product offerings. Between 2005 and 2006, satellite radio subscribership rose from 9.3 million to 13.7 million — a nearly 50 percent increase. And combined revenue grew by nearly 100 percent. Indeed, in the two years after XM raised its price by 30 percent,⁵³ it subscribership more than doubled.⁵⁴

⁵² Bernstein Resaerch, June 19, 2006, pp. 4-8,

⁵³ Sidak, p. 11.

⁵⁴ Banks, Tables, XM Satellite Radio and Satellite Radio.

Churn rates are low,⁵⁵ conversion high⁵⁶ and demand appears to be quite inelastic.⁵⁷

The most pessimistic projections for future growth put the average annual growth rate through 2010 at 14 percent per year. The most optimistic puts it at 30 percent.⁵⁸ Satellite radio has secured a preeminent position in the automobile market, with some analysts expecting a satellite radio to be viewed as a necessary option – “auto manufacturers will see it as a necessary option to maintain competitiveness within the auto industry itself. We liken this to the gradual standardization of features (such as CD players and before that air conditioners) that were once premium options upon initial introduction in vehicles.”⁵⁹

These data are not consistent with a market that competes with the burgeoning market for mobile digital listening devices. Experience and careful analysis suggests that the effort to position satellite radio as merely one product option in a broader product market should be rejected.

Finally, entry into the satellite Digital Audio Radio Services (SDARS) market is restricted by the need to have a license to broadcast at frequencies that enable the service to be provided nationwide. During a Senate Judiciary Committee hearing Sirius CEO Mel Karmazin conceded that it was unlikely that another satellite-based competitor would enter the market because of the high barriers to entry. Perhaps because of those barriers and the need to ensure competition existed, the original SDARS licenses were issued by the Federal Communications Commission under strict conditions that the two entities are not allowed to merge.

⁵⁵ Craig Moffett and Amelia Wong, *Sirius (SIRI) and XM (XMSR): Back to First Principles... Lowering SIRI Target Price, but Reiterate Outperform*, Bernstein Research, Feb. 21, 2006.

⁵⁶ Craig Moffett and Amelia Wong, *XM Satellite Radio (XMSR): Lowering Target price to Reflect Conversion Rate Concerns: Maintain Outperform*, Bernstein Research Call, Feb 17, 2006

⁵⁷ Sidak, pp. 10-11.

⁵⁸ See note x.

⁵⁹ Banks, p. 3.

Given these market fundamentals, it may be surprising to find the stock market prices of satellite radio depressed. In June 2006, Bernstein Research explained the causes of the negative view and argued that they were focusing on the short term, in an industry that requires a long term view.

Despite recent negative headlines, mostly from XM, and the precipitous fall in Sirius and EX share prices, the satellite radio business (if not the stocks) actually look quite healthy. The profitability model satellite radio is not broken, subscriber growth trends remain strong, and the profitability prospects of the industry remain bright. We believe that investors willing and able to stomach the high volatility inherent in the group will be rewarded.⁶⁰

Bernstein has repeatedly explained the fundamentals that point in a positive direction.

Satellite radio is a business with high upfront fixed costs; building and launching satellites, building a programming capability, and creating a ground based infrastructure. But the incremental margin generated by each subscriber is very high, in the range of 65%. This variable contribution is much higher, for example, than that of cable TV or satellite video, where variable programming expenses consumer as much as 40% of revenues. As such, the platform has a much higher degree of operating leverage, allowing rapid margin improvements as subscribers and revenue grow. We expect current negative margins to improve quickly in the next few years, and project long run EBITDA margins will reach approximately 40% by 2010, and will eventually climb above 50%.⁶¹

This is a sector that requires penetration to produce profitability over the long term. A year later, Bernstein pointed to the positive signs.

Declines in SAC (subscriber Acquisition costs) and CPGA (cost per gross addition) at XM this quarter show the return to a more normal competitive environment. Continued improvements in contribution margins at both XM and Sirius illustrate the operating leverage of the satellite radio platform. We believe that the duopoly economics of the industry will enable XM and Sirius to earn very attractive margins going forward. Investor fears of competition

⁶⁰ Bernstein Research, *Satellite Radio: Revising Models to Reflect Lowered Guidance; Targets Look Attainable. Continue to Prefer XM*, June 19, 2006, p. 1.

⁶¹ Bernstein Research, *XMSR: Few Surprises, but Strong Second Quarter Affirms Positive Long Term Trend* (July 29, 2005), p. 4.

from other technologies, such as iPods and cellphones, appear overdone as well.⁶²

Bernstein concludes that “a merger is not required to support a strong investment case.”⁶³ The Bernstein Research analysis of the negative news of late 2005 and early 2006 is instructive to understand the competitive dynamic in the sector. The “duopoly economics” that “will lead to attractive long-term profitability,” was interrupted by a period of intense competition between the two providers of satellite service.

XM’s SAC and CPGA rose significantly in the fourth quarter, as it engaged in more discounting and promotional activity than management originally planned for when given guidance (discounting of hardwire directly increases SAC)...Management guided to further declines in SAC and CPGA ad the year progresses. This declining trend is consistent with management’s statements that their promotional posture in the fourth quarter was temporary, in response to the “Howard Stern Effect” in \$Q:05 and 1Q:06.⁶⁴

It is the head-to-head competition between satellite radio providers that is the central competitive force in the sector. As discussed below, the merger is intended to eliminate that primary line of competition.

⁶² Bernstein Research, May 12, 2006, p. 4.

⁶³ Bernstein Research, *XM Satellite Radio (XMSR): Clearer Skies Ahead* (July 5, 2005), p. 1.

⁶⁴ Bernstein Research, May 12, 2006, p. 4.

IV. THE FALSE PROMISE OF BANK SHOT COMPETITION, BENEVOLENT MONOPOLY AND MERGER CONDITIONS AS A SUBSTITUTE FOR HEAD-TO-HEAD COMPETITION

A. INTERMODAL COMPETITION AND BENEVOLENT MONOPOLY

If this merger is approved on the basis that different audio platforms are available, consumers will lose: the track record of intermodal competition disciplining anticompetitive abuse is poor at best. “Bank shot competition” — the claim that partial or poor substitutes that are fundamentally different than the target product serve as competitors — has failed to protect consumers in similar situations. The result of relying on such competition in both merger and regulatory reviews has been rising prices and stagnation.

Cable television provides an appropriate example. In the 1980s, federal policymakers claimed that cable TV competed with over-the-air broadcasting. Based on that understanding, the FCC deregulated cable systems in communities with three or more broadcast signals. Cable rates subsequently skyrocketed. By the late 1980s, the failure of this intermodal competition to discipline cable pricing was so obvious that the FCC proposed to increase the number of over-the-air stations necessary to represent effective competition to six. Seeing the results of this failed policy, Congress re-regulated cable in the early 1990s, and intervened in the market to help DBS satellite compete against cable (another form of intermodal competition).

In the decade after the Telecommunications Act of 1996, which largely deregulated cable rates, intermodal competition between cable and satellite failed to discipline cable rate increases. Average monthly cable bills have doubled since the 1996 Act. In short, intermodal competition from neither over-the-air TV nor from digital satellite distribution has disciplined

cable rates. The former had more limited channel capacity; the later had greater channel capacity. It did not matter. The empirical evidence from the cable market is clear. Only head-to-head competition of products within the relevant market delivers clear relief from anti-consumer, anticompetitive pricing.⁶⁵

In the satellite radio service product space, we face a similar configuration of products. Congress, regulatory agencies and antitrust authorities should not be misled into believing that traditional broadcast radio, digital Internet distribution and mobile handheld devices, like iPods, that allow consumers to store and play music from their own collections or from online music sites, will discipline prices any more than broadcast television, downloadable videos, DVD players, Digital Video Recorders and direct broadcast satellite have disciplined cable prices. The contention that the purported substitutes will discipline prices is even more suspect when one considers that the cost of satellite radio service has increased since the product were launched several years ago despite the presence of other mobile radio distribution systems. Free terrestrial radio and iPods have been around for a while, but their existence has not prevented increases in satellite radio pricing practices. There is no reason to believe that it will do a better job if a satellite radio monopoly is allowed to come into existence.

The merging parties argue that consumers will be better off with a benevolent monopolist than they would be with two competitors. In this ultra-short term view, competition is defined as wasteful, since redundant facilities lie unutilized. The monopolist can serve everyone while using less resources and the monopolist promises not to abuse the market power that would result. But without the stick of meaningful competition, the cost

⁶⁵ Comments of Consumer Federation of America, et al., *Cable Horizontal and Vertical Guidance*.

savings simply will not be passed through to the consumer. Indeed, the increase in market power will allow the post-merger monopoly to raise rather than lower prices.

The merging parties promise, in the short-term, not to raise prices for the services that consumers now receive. It is a hollow promise that fails to address the real harms of the merger. Time-limited price freezes today for yesterday's services fail to address the added costs to consumers over time that result when competition is absent. In addition, a short term price freeze does not compensate for benefits they would have gained from price declines consumers may enjoy if the two competitors continue to compete. In the absence of a merger, it is not clear why prices should not eventually fall below \$12.95/month for existing services as increasing subscribership drives down costs. In addition, with the loss of two head-to-head competitors, consumers will suffer from the gradual price creep that will likely occur over time, as in the monopolistic cable industry. Gradual increases, though less noticeable, have a dramatic adverse impact on consumers over time. A five to ten percent annual increase over a period of years takes a significant bite out of the consumer's wallet, as any long-time cable subscriber will attest.

B. CONSUMER CHOICE DENIED

XM and Sirius assert that a significant benefit of the merger is that consumers will be offered more choice. A careful analysis demonstrates that such choice is badly circumscribed, comes at a cost, and is insufficient to compensate for the lost choice consumers have now: the ability to choose services from two competitors.

First, XM and Sirius contend that eventually they will be able to receive content offered on both systems and in the short term, consumers will be offered some of the content offered on the other competitors system but unavailable from their current service. For

example, subscribers currently able to get only the NFL or NLB channels will be able to purchase both. Note, however, that the purported increased choice will come at a cost. The merging parties do not claim to offer those additional channels at the same cost of existing services. The parties offered concession to hold prices near current levels not only does little more than freeze pricing for yesterday's services, that promise does not apply to new packages that include the combined services of the two companies. In fact, it is very likely that the "merger benefits" of combining these offerings will require consumers to pay much more than \$12.95/month to receive premium channels. It is reasonable to expect that to get those premium channels, consumers would likely be required to "buy-through:" to receive the premium channels at additional cost, they will likely be required to first buy the large basic package.

Second, despite XM and Sirius claims that channel capacity is not a limiting factor, significant concerns exist that to make those additional programming options available, the services will have to drop existing channels, including non-duplicative offerings, reducing consumers' choice, or alternatively degrade audio quality.⁶⁶ Channels with specific DJs they once had available may be unavailable. In that case, there is little consumer benefit to the merger and substantial costs in terms of lost channel choice. And when dual platform receivers ultimately become available, enabling consumers to receive all channels from both providers, it is unclear what they'll cost and whether the parties will offer them to consumers at reduced cost.

Third, the merging parties assert that they'll offer consumers greater choice by offering perhaps specialty channels or give them the ability to opt-out of channels and deduct the cost

⁶⁶ Charles Babington, "Radio Deal Could Face Technical Difficulties," *Washington Post*, D1, March, 19, 2007.

of those channels from their bill. This choice, however, could be available today. But instead, consumers in the satellite radio space are afflicted by the very same pricing practices that afflict cable consumers. Not only are prices high, but also the consumer is offered only large bundles of channels over which they have no choice. Consumer choice and consumer sovereignty are denied. In a product market where the marginal production cost of adding subscribers is almost zero, the bundling strategy is largely anti-consumer.⁶⁷

This merger promises to make matters worse, with large capacity systems joining to create larger consumer bundles at higher prices. The offer to give consumers greater pricing flexibility is not accompanied by promises that consumers won't be forced to buy-through to get specialty bundles, nor by assurances that the "cost" deducted from consumers for "opt-out" channels will actually reflect the cost of the programming for that channel. The cost to Sirius of Howard Stern's channel, which some listeners may find objectionable, is arguably higher than the cost of a music channel, where production costs are substantially lower. The merging parties' concession not only fails to provide the real channel-by-channel choice consumers demand, it is unlikely to provide any meaningful cost benefits.

The purported choice benefits simply do not compensate for the real choices consumers will lose: the choice between two head-to-head competitors. Today, consumers who want different options have the ability to switch providers, albeit at significant switching costs. But that possibility forces the two providers to continue innovating, improving their services, developing differentiating features like package flexibility and competing on price. Because this is a unique product market, once the competition is eliminated, the primary

⁶⁷ The marginal production costs are certainly every low, if not zero, but we are told that the marginal transaction costs (i.e. customer acquisition costs) are high. However, it appears that this problem is a function of the bundling strategy. Having set such a high threshold price, the companies are forced to market aggressively to much narrower market segment.

driver of innovation and progress in both programming and technology – competition in the market – will be eliminated. Innovation will slow to the pace preferred by the monopolist.

In addition, the merger harms independent content producers, DJs, artists and personalities who now have two competitors to play off one another when negotiating for carriage or "air-time." As we have seen in cable, concentration in distribution reduces access for content producers. Proposals made by some that, as a condition of the merger, some capacity should be reserved for independent non-commercial channels may promote some content diversity, but it does not compensate for the loss of bargaining power that independent *commercial* content producers will suffer when faced with the market power of a single distributor for their content. At the end of the day, the loss of choice for content producer translates into fewer choices and less program diversity for consumers.

As the merging parties assert the benefit of the merger as greater consumer choice in channel programming offered by both parties, there has been little focus on the fact that it is the parties' own practices that have denied consumers this choice in the past. Despite requirements by the FCC and the terms of their own patent dispute settlement to develop and provide interoperable radios that would have allowed consumers to switch providers without switching equipment, the companies have failed to meet that commitment. Claims by XM and Sirius that they were required only to "develop" the radio, but not to take steps to ensure it was commercially available provides little comfort to consumers denied greater switching choice nor should it ease criticism that these parties sought to comply with only the narrowest interpretation of the commitment. Instead of promoting consumer choice, the merging parties have forced consumers to invest in equipment that works with just one service, and once so invested, their choice is reduced. Today, we are asked to recognize choice benefits of a

merger between two parties who have made concerted decisions to deny consumers choice that would otherwise have been available.

C. THE ANTI-COMPETITIVE AND ANTI-CONSUMER EFFECTS OF THE MERGER CANNOT BE ADDRESSED BY MERGER CONDITIONS

Even supporters of the merger cannot hide the fundamental fact that XM-Sirius will gain market power both as a buyer of inputs and a seller of output. As a buyer of inputs, it would gain leverage over auto manufacturers and content producers. Wall Street analysts who support the merger recognize that this is where the value lies. For example, David Bank of RBC Capital Markets, who was advocating the merger even before it was proposed,

While significant realizable synergies exist, the most valuable synergies will not likely materialize until longer terms OEMs (who won't have two entities to play off each other anymore) contracts expire....

At that juncture, we believe satellite radio will be sufficiently penetrated in the overall vehicle base that auto manufacturers will see it as a necessary option to maintain competitiveness within the auto industry itself.

We then assume that a combined XM/Sirius would be able to negotiate a 20% decrease in each contract upon its renewal, given the leverage of only one satellite radio operators versus two previously....⁶⁸

The most substantial near-term synergies should materialize in advertising, which is essentially a fixed cost and, in our opinion, could be reduced by nearly 50 percent.⁶⁹

Aside from these effects, Banks essentially sees the elimination of all competitive costs between the two companies. Thus, advertising and research and development costs are both projected to decline 50%.⁷⁰ Moreover, he projects a 50% decline in general programming costs due to the elimination of channels.

⁶⁸ Banks, pp. 2...3...4.

⁶⁹ Banks, p. 4.

⁷⁰ Banks, pp. 3, 5.

In the near term, we also think it is likely that XM Sirius would initially maintain unique programming on separate systems (i.e. Howard Stern and the NFL would continue to be broadcast exclusively on Sirius and Oprah and MLB exclusively on XM), The general programming (music, talk, weather) channels would likely be consolidated into roughly 80-100 channels that would be broadcast on both XM and Sirius platforms simultaneously. Thus, we model a 50% reduction in overall programming costs by 2010... Eventually however, the company would likely migrate to one platform for all subscribers. We envision a potential scenario of one combined satellite radio service with 160 channels of music/audible content with the remaining spectrum used for video.⁷¹

The opponents of the merger make the same arguments,⁷² but the basic point is that the fabric of the merger is anti-competitive and anti-consumer. It is hard to see how a 50 percent reduction in programming costs, research and development and advertising promotes consumer choice and innovation.

Bernstein Research is less sanguine about the short term synergies, but long term it sees the merger having similar effects.

The longer-term strategic synergies are far greater, however. Programming contract renewals would suddenly be uncontested. Automotive revenue sharing agreements would be renegotiated without another satellite radio operator to offer a better deal. Commission arrangements with retailers could be offered on a virtually take-it-or-leave basis.⁷³

This is a stunning recital of market power that could not exist if satellite radio were really part of a market that was vigorously competitive at the point of sale. If the alternative distribution platforms were really competitive, the prices paid to content producers, auto OEMs, and retailers, would already reflect that competition and the elimination of head-to-head competition between the two satellite providers would not have such a dramatic effect on the terms of trade. These projections of the market power effects of the merger on the

⁷¹ Banks, p. 4.

⁷² Carmel Group, *Higher Prices, Less Content and a Monopoly: Good for the Consumer? The Proposed Sirius-XM Merger*, April 2007.

⁷³ Bernstein Research, *XMSR and SIRI: Where to From Here?*, February 20, 2007, p. 6.

supply-side are consistent with the market structure analysis on the demand-side and the observed ability of the industry to raise prices. The intermodal alternatives are not good substitutes. It is intramodal, head-to-head competition that drives the sector.

D. HAZLETT’S RANT FOR THE MERGER

1. Abandoning Antitrust Practice

Thomas Hazlett was employed by XM-Sirius to provide an economic justification for the merger.⁷⁴ It is clear from Thomas Hazlett’s study that under antitrust law and practice, even the extremely merger-friendly version currently practiced by federal authorities in Washington, D.C., this merger does not stand a chance. So Hazlett simply urges the antitrust authorities to abandon the essential core of merger analysis.

Hazlett tries to decouple merger review from competition analysis.

Courts and regulatory authorities grapple with the issue by examining various price and output measures, along with consumer surveys and other evidence. What is a more fundamental point in any competitive analysis, however, is that the burden of proof should not be on the marketplace. That is to say, where increasing consumer welfare is the objective of public policy, the question is not whether the market – as defined one way or the other – is sufficiently competitive. The determinative policy cut is *whether the proposed merger will likely increase or decrease the value of services available to consumer.*⁷⁵

Arguments as to the relevant market and its competitiveness are secondary. The primary consideration is whether a given transaction will benefit consumers and the economy.⁷⁶

This “intense” inter-modal competition is not centered on price. Given the rather disparate pricing models of advertising-supported terrestrial broadcasting, subscription satellite radio, MP3 devices, and other emerging digital media, it is clear that the competitive frontier is largely defined in terms of quality and convenience of service...

⁷⁴ Thomas W. Hazlett, *The Economics of the Satellite Radio Merger*, June 14, 2007.

⁷⁵ Hazlett, p. 12.

⁷⁶ Hazlett, p. 13.

This seriously undercuts the applicability of the SSNIP test, used for defining antitrust markets, in the context of the satellite radio merger.⁷⁷

Crucial aspects of rivalry are not captured in standard static models focused solely on price competition. But they form virtually the entire whole of what is interesting and competitive about the market for audio service.⁷⁸

The claim to decouple competition from consumer welfare for purposes of merger review is a sleight of hand. Without sufficient competition, there is no driving force to compel improvements in quality or require firm with market power to share efficiency gains with consumers in the form of price reductions. And, Hazlett knows it. His argument is really about market definition – a claim that all forms of audio entertainment are in one big market, which “places satellite radio in a safely competitive context”⁷⁹ – but his evidence is so weak he tries to dress it up as a new paradigm of how to look at mergers.

The market structure Hazlett describes is a natural monopoly segment in an intermodally competitive sector, where the central line of rivalry is product quality, not price and intramodal (head-to-head) competition within the segment is meaningless. The empirical support for the claim is feeble at best, nonexistent at worst.

He provides no discussion of product or geographic market. Hazlett presents a simplistic “share of stomach” argument, claiming essentially ‘people listen to sounds from various technologies; therefore they must be competitive substitutes.’ The courts demand more. The fact that people drink water and Coca Cola in the same day does not establish sufficient competition between water and Coca Cola to prevent the exercise of market power by Coca Cola, should it propose to acquire Pepsi.

⁷⁷ Hazlett, p. 19.

⁷⁸ Hazlett, p. 28.

⁷⁹ Hazlett, p. 19.

Furchtgott-Roth expands the share of stomach analysis to include all forms of nutrition. He counts not only one-way audio entertainment, but two-way communications in the market definition.⁸⁰

Alternative technologies certainly exist to deliver different types of content in different circumstances and over different geographic areas, but that does not mean they are in competition. Hazlett has found a fellow who uses them all (at a likely cost of \$1,500 per year in subscription fees and \$1,500 in hardware costs, compared to \$155 per year in satellite radio subscription fees) and concludes that they must be substitutes, but the discussion equally suggests that they are complements.⁸¹ The mere existence of choice is not proof of competition.

Having claimed that competition in this space is about product quality, not price, he never analyzes the product attributes along which competition is supposed to be occurring. The quantity or type of programming available on each of the media is never discussed. The implications of different business models are not explored. Switching costs are never considered and barriers to entry receive only the briefest mention – Hazlett concedes that a new satellite entrant is unlikely. Hazlett has not refuted the claim that this is a separate market, he has just ignored it.

2. Ignoring the Economic Reality

As noted above, at least some of the Wall Street analyses on whom Hazlett depends for his claims that efficiency gains will lead to consumer benefits provide evidence that

⁸⁰ Harold Furchtgott-Roth, *An Economic Review of the Proposed Merger of XM Sirius*, Ex parte filing, RE; Consolidated Application for Authority to Transfer Control of XM Radio Inc. and Sirius Satellite Radio Inc., MB Docket No. 07-57, June 27, 2007, p. 25.

⁸¹ Furchtgott-Roth, p. 14, recognizes that the prices of the mobile internet services are much higher than Satellite radio, ranging from \$49.99 to \$79.99 and claims that newer technologies will lower these prices, but provides no projects as to when or by how much.

undermines his argument. The largest and most immediate efficiency gains come from actions that indicate it is intramodal competition that drives the satellite companies, not intermodal competition.

If vigorous intermodal competition defines this market and the intramodal competition is unimportant, why is the largest and most immediate gain a 50 percent reduction in marketing costs. In other words the Wall Street analyses assume that the merged party will not have to work as hard to gain customers. One intramodal competitor is worth all of the intermodal competitors combined and then some. Even this is too generous to intermodal competition, since in a new product market, a lot of advertising just educates the public about its existence.

Hazlett and the Wall Street crowd also expect the merged firm to use its monopsony power to lower the price they pay for inputs. No one will lament Howard Stern or Oprah Winfrey taking a pay cut, but the thousands of other lesser artists will feel the same oppressive boot of monopsony power, as will the auto manufacturers. If the primary driver of competition in the sector were intermodal, we would not expect to see such a large effect on the supply-side of inputs from the removal of intramodal competition.

If vigorous intermodal competition defines this market and the intramodal competition is unimportant, why do the Wall Street analysts predict a dramatic reduction in the total number of channels made available by satellite radio. The bias against intramodal competition in Hazlett's argument is clear. Hazlett prefers the "benign monopolist model." If the two satellite providers each has a country channel, he declares it a waste, not noticing that the channels will have different DJs and different play lists. Without competing country channels, the monopolist will decide which lists to play and use the second channel for

something else. In this case, the Wall Street analysts don't even expect the something else to be music. They think it will be video. The driver of competition to improve service for country listeners are undermined by the merger.

3. The Natural Monopoly Claim

The natural monopoly claim is also suspect, as suggested above by Bernstein Research.

This is a high sunk cost industry reliant on mass market penetration to achieve profitability. It takes time. Neither of the companies is claiming a failing firm defense for the merger. Contrary to Hazlett's claim, Wall Street analysts see growing subscription rates and profitability in the near future. Hazlett insists that their failure to achieve immediate profitability is an indicator of a lack of market power, when it is part of the normal cycle in an industry such as this. Essentially Hazlett transforms the failing firm proviso into an "immediate profit proviso."

Hazlett also does not consider whether management mistakes might be the cause of the slow ramp up in subscribers and profitability. The industry increased prices during the penetration phase, a bad strategy. It has refused to consider anything but an all you can eat fixed price. Although the entrants were required by the FCC to establish interoperability, they have failed to do so. Instead, they differentiate themselves in key content categories like sports (major league baseball) and talk (naughty v. nice, Stern v. Winfry) and refuse to interoperate. This retards penetration. Coincidentally, they discover that they can offer more consumer friendly-pricing and interoperability, but only after the merger. They could do the same thing without the merger and speed adoption, undermining the natural monopoly claim.

4. Innocence by Association

Aside from the “share of stomach” and “immediate profitability” arguments, Hazlett’s primary evidence that there is intermodal competition are the regulatory comments and activities of the NAB. The fact that they oppose satellite is, for Hazlett, dispositive. He mentions it 29 times and includes an appendix with 21 examples. If the broadcasters don’t like it, it must be good for consumers.

Hazlett rejects a counter explanation offered by a consumer advocate at a Congressional hearing “The NAB would like to eliminate every shred of competition, no matter how minor and indirect. That does not constitute evidence that such competition is effective or sufficient to prevent abuse.” Hazlett disagrees. “Actually, so far as the merger is concerned, it does.”

Hazlett’s suggestion is that even the slightest shred of competition, no matter how minor and indirect is adequate to prevent abuse. He never examines the product or geographic markets involved in the merger nor does he show that there is effective competition between satellite and the other products he cites to prevent abuse. He never considers asymmetric competitive problem that terrestrial radio faces *vis-a-vis* satellite.

As a result, all of his claims of consumer benefit or the lack of consumer harm are unsupported and wrong. Indeed, his primary claim is that because Wall Street analysts project efficiency gains, the merger must be good for consumers. Without adequate competition, however, the purported benefits of these efficiency gains will not materialize. If performance is the key, the lack of competitive pressure will slow innovation. If price is the key, efficiency gains will not be passed through to consumers

Turnabout is fair play. What does the fact that XM-Sirius have offered to submit themselves to regulation that would restrict their market power, tell us. It must mean

that they know they have market power and could not convince regulators to allow the merger to go forward without subjecting that market power to regulation. This conclusion is reinforced by the fact that most merging parties resist conditions vigorously and only accept them grudgingly. A situation in which the merging parties offer up regulation must be really ugly. Their original acceptance of licenses with a condition that mergers not take place, suggests the same.

Another explanation might be that parties to merger proceedings will say just about anything (and frequently contradict themselves) in pursuit of their own interests. The regulatory posturing of business should be given little weight, compared to empirical evidence on market structure. Hazlett's rant is long on the former and short on the latter.

E. CONCLUSION

We have demonstrated that satellite radio is a new and distinct market with high fixed costs requiring an expanding subscriber base to succeed. Subscribership is growing rapidly and projected to bring the companies into positive cash flow in the near future. Competition between the only two service providers is evident. The merger of the only two service providers will undermine the competitive fabric of the product market and have negative consequences on consumers. So obvious are the anticompetitive effects of the merger that the parties have offered to allow themselves to be regulated. The minor concessions they have offered cannot repair the competitive harm that will be done. The vague and general price relief that XM-Sirius have suggested cannot compensate for the harm to competition. More importantly, it is difficult to see how any conditions could repair the competitive harm. The FCC or the FTC would have to regulate the prices a merged XM-Sirius pays for its inputs, the amounts it spends on R&D, and the number and types of channels it offers.

A satellite radio merger to monopoly is also about an avalanche of mergers. There was a key moment a decade ago when the Department of Justice decided that a large monopolist is no worse than two smaller monopolists and allowed the Bell Atlantic-NYNEX merger to go forward. That decision opened the door to a wave of mergers that doomed head-to-head competition in telecommunications. The old telephone monopoly was recreated as two huge geographically distinct monopolies that rarely, if ever, compete.

A satellite radio merger to monopoly will perform a similar bellwether function. If the agencies with oversight adopt a loose definition of products and markets and allow a merger to monopoly on the basis of intermodal competition, then a tsunami of mergers could ripple through the digital space at the worst possible moment. The firms that have declared their undying hostility to the open flow of products in the digital economy (broadcasters, telephone/cellular companies, cable companies), will now be empowered to capture and stifle the alternatives, under the premise that every media and telecommunications product competes with all others and that new technologies and services will come along to protect the consumer in any case. That relief, however, will be slow and insufficient because the competitive core of the digital economy will have been damaged and the critical terrain of the digital economy will be controlled by entities that have the same anti-competitive, anti-consumer objectives as the merging parties in this case.