



Consumer Federation of America



May 7, 2008

VIA ECFS

**Marlene H. Dortch**  
**Secretary**  
**Federal Communications Commission**  
**445 12<sup>th</sup> Street, S.W.**  
**Washington, D.C. 20554**

**Re: Written *Ex Parte* in Connection with the Consolidated Application for Authority to Transfer Control in Connection with the Sirius/XM Merger, as Amended (MB Docket No. 0757)**

Dear Ms. Dortch:

The recent decision by the Department of Justice (DOJ) to approve the condition-free merger of XM and Sirius is based on a fundamentally flawed analysis of the satellite radio market. The Federal Communications Commission (FCC) must not repeat the DOJ's error. The public interest standard under which the FCC reviews mergers, and the specific conditions in the licenses granted to XM and Sirius, makes it all the more evident that the proposed merger is not in the public interest. In this *Ex Parte* letter we outline where the DOJ went astray and what their errors mean for the FCC's analysis. The DOJ analysis does not seriously engage the extensive analysis nor rebut our findings and conclusions.

This is a merger to monopoly that would eliminate substantial competition in the satellite radio market and confer significant market power on the post merger monopolist, which explicitly violates their license terms. This creates an extremely high burden on the merging parties.

To make matters worse, the parties violated another term of their license, which required them to produce an interoperable radio. This bad behavior has harmed the public, but the licensees now demand a reward (i.e. approval of merger) to deliver on their original promise. Absent the merger, interoperable radios would have improved the performance of the satellite market by increasing competition. With the merger approved, it will rob consumers of that competitive benefit.

The conditions on the original license, which were imposed by the FCC to protect the public interest, are specific to the FCC's review of the merger and set a much high standard than the DOJ applied. As a general matter, the standard for merger review at the FCC is higher than under the antitrust laws – “to promote the public interest” – because media have a unique role in our culture and democracy.

### **The Flawed Department of Justice Analysis**

The Department of Justice decision to allow the XM-Sirius merger abandons all of the most basic principles of antitrust analysis and will prove disastrous not only for satellite radio consumers

but for all consumers as the door is swung wide open for a raft of anticompetitive and anti-consumer mergers. DOJ has replaced the real world analysis of likely near term impacts (a standard that has been applied by antitrust authorities for decades) with projections about entry in the long term. It has abandoned the emphasis on actual and potential competition in favor of hypothetical competition. And most troubling, the DOJ's analyses essentially rewards the anticompetitive strategies utilized by the two satellite radio companies. Under this new standard, literally anything goes.

In its analysis, the DOJ concedes that XM and Sirius:

- Did compete for the automaker distribution channel;<sup>1</sup>
- Do compete for a great deal of programming, music, niche new and talk<sup>2</sup>;
- Did compete for marquee programming;<sup>3</sup>
- Do compete in the retail distribution channel;<sup>4</sup> and
- Would have competed more if they had kept their promise to deliver an interoperable radio.<sup>5</sup>

The DOJ concludes that XM and Sirius have differentiated their products just enough so that they do not compete with one another on critical attributes, but not enough to prevent others from competing with them.<sup>6</sup> Thus, because XM-Sirius have pursued strategies that have locked in current customers by failing to provide interoperable radios<sup>7</sup> and differentiating their product with highly

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<sup>1</sup> Historically, XM and Sirius engaged in head-to-head competition for the right to distribute their products and services through each automaker. As a result of this competitive process, XM and Sirius have provided car manufacturers with subsidies and other payments that indirectly reduce the equipment prices paid by car buyers to obtain a satellite radio.

<sup>2</sup> XM and Sirius seek to attract subscribers in a wide variety of ways, including the offering of commercial-free music (with digital sound quality), exclusive programming (such as Howard Stern on Sirius and "Oprah & Friends" on XM), niche music formats, out-of-market sporting events, and a variety of news and talk formats in a service that is accessible nationwide. The variety of these offerings reflects an effort to attract consumers with highly differentiated interests and tastes. Thus, while the satellite radio offerings of XM and Sirius likely are the closest substitutes for some current or potential customers, the two offerings do not appear to be the closest substitutes for other current or potential customers.

<sup>3</sup> *Id.*, references to Howard Stern and Oprah & "Oprah and Friends," as well as competing out of market sporting events.

<sup>4</sup> The Division's investigation identified the mass-market retail channel as an arena in which XM and Sirius would compete with one another for the foreseeable future. Both XM and Sirius devote substantial effort and expense to attracting subscribers in this arena, with both companies offering discounts, most commonly in the form of equipment rebates, to attract consumers. Retail channel sales have dropped significantly since 2005, and the parties contended that the decline was accelerating. However, retail outlets still account for a large portion of the firms' sales, and the Division was unable to determine with any certainty that this channel would not continue to be important in the future.

<sup>5</sup> XM and Sirius made some efforts to develop an interoperable radio capable of receiving both sets of satellite signals. Depending on how such a radio would be configured, it could enable consumers to switch between providers without incurring the costs of new equipment.

<sup>6</sup> For example, a potential customer considering purchasing XM service primarily to listen to Major League Baseball games or one considering purchasing Sirius service primarily to listen to Howard Stern may not view the other satellite radio service, which lacks the desired content, as a particularly close substitute. Similarly, many customers buying radios in the retail channel are acquiring an additional receiver to add to an existing XM or Sirius subscription for their car radio, and these customers likely would not respond to a price increase by choosing a radio linked to the other satellite radio provider.

<sup>7</sup> For example, the DOJ's decision declared "[b]ecause customers must acquire equipment that is specialized to the satellite radio service to which they subscribe, and which cannot receive the other provider's signal, there has never been significant competition for customers who have already subscribed to one or the other service... As to existing subscribers, the Division found that satellite radio equipment sold by each company is customized to each network and will not function with the other service....The Division's investigation revealed, however, that no such interoperable radio is on the market and that such a radio likely would not be introduced in the near term. For example, in the important automotive channel, such a radio could

specialized marquee programming, and locked out competition for auto manufacturers for four years with long-term contracts,<sup>8</sup> the DOJ concludes that the merger will not reduce competition enough to harm the public. The DOJ analysis is riddled with holes:

- However, DOJ ignores the fact that satellite radio market is a young industry where the number of new customers projected over the mid-term exceeds the number of current customers;<sup>9</sup>
- DOJ does not realize that current customers benefit from the competition for new customers. Such benefits include the development of new programming, higher quality transmission, and new equipment.<sup>10</sup>
- DOJ contradicts itself by asserting that the powerful barriers to competition that XM-Sirius have built with product differentiation to prevent diminish the competition between them will not prevent other technologies from competing with the merged entity, even though the merged entity will have a broader slate of unique content and the alternative technologies will have none.

The merging parties have failed to provide convincing evidence that non-satellite audio products are good or close substitutes for satellite radio service<sup>11</sup> and the DOJ's analysis confirms that non-satellite audio products are not good substitutes.<sup>12</sup>

The DOJ even argues that one big monopoly is no worse than two little monopolies, stating that one person developing one radio is better than two people developing two radios.<sup>13</sup> Unlike the DOJ, when two different service providers work to develop new radios or produce two different

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not be introduced in the near term due to the engineering required to integrate radios into new vehicles. The need for equipment customized to each network means that in order to switch from XM to Sirius, or vice versa, a subscriber would have to purchase new equipment designed for the other service. In the case of a factory-installed car radio, switching satellite radio providers would have the additional disadvantage of requiring an aftermarket radio that would be less integrated into the vehicle's systems. Data analyzed by the Division confirmed that subscribers rarely switch between XM and Sirius."

<sup>8</sup> However, XM and Sirius have entered into sole-source contracts with all the major automobile manufacturers that fix the amount of these subsidies and other pertinent terms through 2012 or beyond. Moreover, there was no evidence that competition between XM or Sirius beyond the terms of these contracts would affect customers' choices of which car to buy. As a result, there is not likely to be significant competition between XM and Sirius for satellite radio equipment and service sold through the car manufacturer channel for many years.

<sup>9</sup> Common Cause, Petition to Deny, p. 36.

<sup>10</sup> Common Cause, Petition to Deny, pp. 37-38.

<sup>11</sup> "Petition to Deny of Common Cause, Consumer Federation of America, Consumers Union and Free Press," *In the Matter of Consolidated Application for Authority to Transfer Control of XM Radio Inc. and Sirius Satellite Radio Inc.*, MB Docket No. 07-57, July 9, 2007, pp. 14-39; and "Supplemental Comments of Consumer Federation of America, Consumers Union and Free Press," *In the Matter of Consolidated Application for Authority to Transfer Control of XM Radio Inc. and Sirius Satellite Radio Inc.*, MB Docket No. 07-57, pp. 10-17.

<sup>12</sup> It is difficult to reconcile the statement that "Radio, MP3 players (e.g. iPods), and audio offerings delivered through wireless telephones. Those options, used individually or in combination, offer many consumers attributes of satellite radio service that they may find attractive," with the extensive reliance on product differentiation and non substitutability that is the backbone of the claim that XM-Sirius do not compete. "thus, while the satellite radio offerings of XM and Sirius likely are the closes substitutes for some current or potential customers, the two offerings do not appear to be the closest substitutes for other current or potential customers." Services with none of the attributes or specialize content are deemed to closer substitutes that services with many of the attributes and more specialty content.

<sup>13</sup> For example, the merger is likely to allow the parties to consolidate development, production and distribution efforts on a single line of radios and thereby eliminate duplicative costs and realize economies of scale. These efficiencies alone likely would be sufficient to undermine an inference of competitive harm.

country music channels, we view it as pro-consumer competition, the offering of choice to consumers, not redundancy. Different DJs choose different songs and provide different chatter to attract customers, which is what competition is all about.

Ultimately, DOJ rests its case on two uncertain hopes. First, it hopes that the merging parties would not exploit their market power in the near term, even though there is no competition to prevent them from doing so, because they will be making a lot more money through uncalculated synergies.<sup>14</sup> Second, it hopes that some new technology will come along in the mid-term to replace the competition that has been lost and prevent future abuses.<sup>15</sup>

## **The Federal Communications Commission Has A Duty to Protect the Public Interest**

The Federal Communications Commission should reject the DOJ's fundamentally flawed economic analysis. The FCC is an independent agency that granted the satellite radio licenses under a specific stipulation that a merger would not be approved and that an interoperable radio would be delivered. Since the delivery of an interoperable radio was an anticompetitive strategy – a key ingredient in DOJ's analysis of the weakening of competition – the FCC has two grounds on which to reject the merger.

We *strongly* oppose this merger and believe a reasoned analysis by the Commission will find no public interest basis for approval of the merger to monopoly. However, if the Commission is inclined to approve this merger based in part on the DOJ's analysis, it must be fully aware of dangerous precedent this will set.

Approval of this merger will result in a "Roadmap to Monopoly" that provides the path for future anticompetitive mergers:

- Differentiate your products just enough to convince the regulators that you don't compete with one another on critical attributes, but not enough to prevent others from competing with you. Never mind that you do currently compete on many attributes and are the most likely competitors for those attributes on which you do not presently compete.
- Convince the regulator to ignore the loss of mid-term competition and that you will pass savings through even though you do not face current competition. Better still,

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<sup>14</sup> It was not possible to estimate the magnitude of the efficiencies with precision due to the lack of evidentiary support provided by XM and Sirius, and many of the efficiencies claimed by the parties were not credited or were discounted because they did not reflect improvements in economic welfare, could have been achieved without the proposed transaction, or were not likely to be realized within the next several years. Nevertheless, the Division estimated the likely variable cost savings – those savings most likely to be passed on to consumers in the form of lower prices – to be substantial. For example, the merger is likely to allow the parties to consolidate development, production and distribution efforts on a single line of radios and thereby eliminate duplicative costs and realize economies of scale. These efficiencies alone likely would be sufficient to undermine an inference of competitive harm.

<sup>15</sup> While it is difficult to predict which of these alternatives will be successful and the precise timing of their availability as an attractive alternative, a significant number of consumers in the future are likely to consider one or more of these platforms as an attractive alternative to satellite radio. The likely evolution of technology played an important role in the Division's assessment of competitive effects in the longer term because, for example, consumers are likely to have access to new alternatives, including mobile broadband Internet devices, by the time the current long-term contracts between the parties and car manufacturers expire.

convince the regulator to define competition as redundancy and declare unregulated monopoly to be in the consumer interest.

- Tell the regulator to hope that something else will come along to restore the lost competition before the mid-term contracts run out.
- Break the promise to develop interoperable consumer equipment so you can raise switching costs that lock-in customers. To the regulator high switching costs now (under the DOJ's reasoning) mean every seller has a local monopoly and therefore can merge with contiguous monopolists.

The FCC should not sanction this roadmap to monopoly by blessing this merger. Furthermore, the Commission should be aware of the potential precedential impact approval of this merger will have on other media ownership rules. Thus, even if the Commission chooses to abandon the competitive model for satellite radio based on the flawed DOJ analysis, it must state clearly that this decision has no precedential value for any other Commission policies governing media ownership. The extremely shoddy market structure analysis conducted by the DOJ would undermine contradict the approach to market structure analysis the Commission relied on in recent decisions including the market structure analysis at the center of the Commission's indecency rulings<sup>16</sup> and the recent media ownership rules.<sup>17</sup>

Respectfully submitted,

CONSUMER FEDERATION OF AMERICA  
CONSUMERS UNION  
FREE PRESS



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Consumer Federation of America

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<sup>16</sup> In the Matter of Complaints Regarding Various Television Broadcasts Between February 2, 2002 and March 8, 2005, *Notices Of Apparent Liability And Memorandum Opinion And Order*, Adopted: February 21, 2006 Released: March 15, 2006

<sup>17</sup> 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; 2002 Biennial Regulatory Review –Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996 Cross-Ownership of Broadcast Stations and Newspapers Rules and Policies Concerning Multiple Ownership of Radio Broadcast Stations in Local Markets Definition of Radio Markets Ways to Further Section 257 Mandate and To Build on Earlier Studies Public Interest Obligations of TV Broadcast Licensees MB Docket No. 06-121, MB Docket No. 02-277 MM Docket No. 01-235, MM Docket No. 01-317, MM Docket No. 00-244, MB Docket No. 04-228, MM Docket No. 99-360 *Report And Order and Order On RECONSIDERATION* Adopted: December 18, 2007 Released: February 4, 2008