

STATEMENT

OF

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BEFORE THE

**ANTITRUST TASK FORCE
COMMITTEE ON THE JUDICIARY
UNITED STATES HOUSE OF REPRESENTATIVES**

CONCERNING

COMPETITION AND THE FUTURE OF DIGITAL MUSIC

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Mr. Chairman, I am Charles E. Biggio, a partner in the law firm of Wilson Sonsini Goodrich & Rosati. I would like to thank the Chairman, the Ranking Member and the Members of the Committee for inviting me to testify on the antitrust aspects of the merger between XM and Sirius. I have practiced antitrust law for over 20 years, including three years (from 1995 to 1998) at the Antitrust Division of the Department of Justice, first as Senior Counsel to the Assistant Attorney General and then as Acting Deputy Assistant Attorney General. My focus both in private practice and at the Antitrust Division has been merger review. While at the Antitrust Division, I devoted substantial time to the wave of radio mergers that followed the enactment of the 1996 Telecom Act.¹

This merger raises important policy and law enforcement considerations. There is no doubt that XM and Sirius have been vigorous competitors for subscribers, talent and distribution. Indeed, I do not understand the parties to be arguing that the merger should be approved because XM and Sirius do not compete. Moreover, XM and Sirius sell something that is different from other media, and so it is plausible that satellite radio is a market unto itself. If so, this would be a “2-to-1” merger and would be patently unlawful under existing precedent. At the same time, there can be no denying that consumers have an increasing number of alternatives vying for their listening time. It is possible that these alternatives are in the same relevant antitrust market as satellite radio. If so, this merger may in fact raise no antitrust concerns. Whether the combination of XM and Sirius is a “2-to-1” merger or a merger in a much larger market is a question of fact. Right now, we do not have all the facts necessary to determine the legality of the merger.

¹ Although in private practice I have represented various terrestrial radio firms from time to time, I am providing this testimony on my own behalf, and not on behalf of any client.

The facts will come out. The facts developed at hearings, like the one held here today, will help the process along. However, merger review is essentially a law enforcement exercise, and the enforcement agencies – the Antitrust Division in particular, along with the FCC – are best equipped to find the relevant facts. My recommendation is that no firm conclusions be formed about this merger until the agencies have completed their review.

I outline below the antitrust principles applicable to this merger and try to identify the key issues that should be examined in evaluating whether the XM/Sirius merger is likely to harm consumers.

HSR Procedure

This merger, like most substantial M&A transactions, is subject to the pre-merger notification and waiting period requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976. XM and Sirius must provide notice to the Antitrust Division of the Department of Justice and the Federal Trade Commission. Although the Antitrust Division and the FTC share merger enforcement responsibility as a general matter, I expect that the Antitrust Division, and not the FTC, will review this transaction, given the Antitrust Division's prior experience with similar mergers (e.g., DirectTV/Echostar and numerous terrestrial radio mergers).

The initial waiting period under HSR will be 30 days. Given the obvious competitive overlaps between XM and Sirius, I expect the Antitrust Division at the end of the initial waiting period to issue a request for additional information – a so-called Second Request – to both XM and Sirius. The issuance of a Second Request defers the ability of the merging parties to consummate their transaction until 30 days after they

have provided the Antitrust Division with the requested information. Ordinarily, it takes at least several months to comply with a Second Request. After all waiting periods have expired, HSR would no longer prevent XM and Sirius from completing their merger. However, as a practical matter, the timing of the HSR process will be determined by the timing of the FCC's review. The FCC's review is not limited by the 30-day waiting periods provided for by HSR. Thus, the parties do not have the ability to put the FCC "on the clock" as they do with the Antitrust Division. Consequently, the timing of the Antitrust Division's review of this merger likely will be determined by the review timeline at the FCC.

As a technical matter, both the FCC and the Antitrust Division have the authority to apply Section 7 of the Clayton Act to mergers that are subject to FCC jurisdiction. In the past, the Antitrust Division and the FCC have worked together closely; however, as the primary enforcer of the antitrust laws, the Antitrust Division in most cases has taken the lead in analyzing the antitrust aspects of a merger. The FCC does apply a broader public interest standard in its review of mergers. However, while the FCC has obtained additional relief in connection with some transactions, I am not aware of a recent case in which there was substantial disagreement between the Antitrust Division and the FCC over the antitrust aspects of a merger. As with prior merger reviews, I would expect that the two agencies will cooperate in their review of the antitrust aspects of this transaction.

Merger Enforcement Standards

In reviewing mergers, the Antitrust Division applies Section 7 of the Clayton Act, which prohibits the acquisition of stock or assets "where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such

acquisition may be substantially to lessen competition, or to tend to create a monopoly.” Merger enforcement standards are forward looking. Although historic performance in an industry often provides relevant evidence, the primary focus is to determine the likely competitive effects of a proposed merger in the future.

The ultimate question the Antitrust Division will ask in reviewing the XM/Sirius transaction is whether the transaction will create or enhance market power; that is, whether it will cause prices to go up, output to go down, or quality or technological development to deteriorate in a relevant market affected by the transaction. The analytical framework used by the Antitrust Division (and generally supported by case law) to answer this question is embodied in the *1992 Horizontal Merger Guidelines* (the “Guidelines”), which were issued jointly by the Antitrust Division and the FTC. Under the Guidelines (and the case law), a transaction is presumptively anticompetitive (i.e., is deemed to create or enhance market power) if it creates undue market share in a highly concentrated market. Thus, the first step in analyzing the competitive impact of a transaction is to define a relevant market (which will have both product and geographic dimensions). After the market is defined, market shares and market concentration are calculated. Where post-transaction market concentration is low, or where the transaction has a trivial impact on concentration, the transaction is generally presumed to be lawful without substantial further inquiry. On the other hand, where a transaction results in high market shares in a concentrated market, the Guidelines call for a more detailed analysis to determine whether a presumption of anticompetitive effect can be overcome by the realities of the marketplace.

The so-called “competitive effects” portion of the Guidelines sets forth a variety of factors to be considered in addition to market concentration to determine whether the transaction will increase the likelihood that market participants will be able to act anticompetitively. In making this determination, the Antitrust Division will evaluate whether the transaction will actually result in higher prices, lower output levels, or deterioration in quality or technological development. These anticompetitive effects can take place either through coordinated interaction among the competitors remaining after the transaction, or through the combined firm’s unilateral exercise of market power created by the transaction. Factors relevant in determining whether the transaction will result in anticompetitive effects include, among other things, changing market conditions, ease of entry, the nature of the products under consideration, the ability of small firms rapidly to increase sales or of non-U.S. firms to increase exports to the United States, the conduct of firms in the market, the size of the merged firm in relation to other firms in the market, the intensity of competition between the products of the merging firms relative to competition with other firms, and, in some cases, the transaction-specific efficiencies (e.g., production cost savings) the transaction will generate.

Application to the XM/Sirius Merger

A single merger can have effects in multiple markets. Each affected market must be examined separately to determine whether competition might be adversely affected in that market. There are at least four distinct “markets” affected by this merger: (1) advertising, (2) distribution (i.e., automobile OEM and retail distribution), (3) content acquisition and (4) consumer subscriptions. Each of these markets has a different set of consumers and, potentially, a different set of competitors. And an anticompetitive effect

in any one of these markets would justify blocking the transaction (absent some remedial undertakings to cure the competitive concern).

Advertising. The market for advertising has been the key market of concern in the Antitrust Division's review of terrestrial radio mergers. Here, however, I would expect the advertising market to be of little concern. First, XM and Sirius do not rely on advertising as their main revenue source – they are relatively small players. Second, the market for advertising would likely include the terrestrial radio companies at a minimum and may well include other non-radio media for any national advertising XM and Sirius may sell. I note that the Antitrust Division has historically taken the position that radio advertising is in a separate market from other forms of advertising. However, this position has usually been articulated in the context of local radio advertising, not national advertising.

Automobile OEM's and Retail Distribution. XM and Sirius compete to be offered as optional or standard equipment on new cars. They also compete to be featured on the shelves of the nation's electronics retailers. I believe this market is a derivative of the market for consumer subscriptions. It would be anomalous to conclude that the merger is likely to be anticompetitive in respect of the auto OEMs and retailers, but not in respect of the ultimate consumer. In any event, there is a relatively small group of sophisticated automobile OEMs and major electronic retailers; if they do not express concerns the proposed transaction, there would be little reason to be concerned about this market.

Content. XM and Sirius compete for content, especially for exclusive content. For example, Sirius was willing to pay over \$200 million for exclusive rights to Howard Stern's program. The relevant antitrust question is whether the combined company will

be able to pay less for its content because of the merger, or will the other outlets for radio content keep the market competitive so that content providers will not be adversely affected? It may be the case that the amount of resources XM and Sirius devote to content acquisition is primarily driven by competition between the two firms. On the other hand, it is also possible that the combined company would continue to have the incentive to pay top dollar for content because it will be in competition for that content with terrestrial radio firms and other distributors of audio content, or because it must do so in an effort to entice new subscribers and keep existing ones as it tries to achieve greater consumer penetration. As with the automobile companies and the electronics retailers, firms supplying radio content are often large sophisticated firms; if they do not express concern, there would likewise be little reason to be concerned about this market.

Consumer Subscriptions. The competition between XM and Sirius for subscribers is the most important aspect of this transaction. The key question is whether the competition between XM and Sirius is the factor determining the subscription price for the two services and the quality of the product being offered. In other words, is the relevant antitrust market satellite radio (i.e., the competition between the two satellite radio services is what determines the market subscription price) or is the market broader (i.e., subscription prices are determined by the full range of listening alternatives available to consumers). Below are some of the factors that will be relevant to the antitrust analysis.²

² This analysis focuses on the relevant product market. There is also a geographic element to the relevant market. Although XM and Sirius operate nationwide, their services are purchased by consumers whose options are available locally. Thus, the geographic market may well be local, and the options available to consumers in one local market may be different from the options available to consumers in another. However, unless economically viable options are determined to be available to consumers in most if not all localities, the differing characteristics of individual local markets are unlikely to be determinative the enforcement decision of the Antitrust Division and the FCC.

- Markets are narrowly defined to include only those products that have a meaningful impact on price. Mergers between “close competitors” or “next best substitutes” are usually problematic, because other products may not be sufficiently viable substitutes to impose a significant price constraint. Once the close substitutes merge, there may be substantial room for price increases before the pricing constraint offered by a more remote substitute kicks in.
- “Substitutes” must be distinguished from “complements”. A substitute is a product a consumer would buy instead of another one. A complement is a product a consumer would buy in addition to another product. Substitute products are competitive; complements are not. This is important because some of the products a consumer might listen to could be complements to satellite radio, and not substitutes.
- Markets are defined by the marginal consumer. Thus, even though many consumers would not substitute away from a product to another product in the face of a price increase, the market could still include the other product if there are enough marginal customers who would switch. Marginal customers need not predominate.
- Even if there are a sufficient number of marginal customers who would switch to another product in the face of a price increase, the market may still be defined narrowly if there is a well defined group of customers who would not switch and who could be charged higher prices than other consumers (i.e., if sellers can price discriminate).

The standard Guidelines analysis would suggest a rebuttal presumption that the relevant antitrust market is satellite radio. However, new products seeking a larger market presence often must compete with a more established technology, even if there is just one producer of the new product. This argument loses its force the longer the “new” product has been on the market, especially where there the new product is sold by two firms competing head-to-head. Thus, a key factual question posed by this merger will be whether satellite radio has come to the point where the gains from consolidating the subscriber bases of the two providers are more significant than the need to keep prices low in order to continue adding new subscribers.

In addition to the market definition and competitive effects analysis, the Antitrust Division and the FCC will consider the efficiencies that may be generated by the merger. To be cognizable under the Guidelines, any efficiencies must be merger specific (i.e., not attainable without the merger or through less anticompetitive means) and verifiable. In addition, efficiencies that would tend to reduce price (i.e., efficiencies that generate lower variable costs) are more apt to be recognized. Fixed cost savings, which typically do not lead to lower prices in the short term, or only credited in limited circumstances. Further, efficiencies almost never justify a 3-to-2 or 2-to-1 merger. Mergers make economic sense for two basic reasons; the merged firm can expect increased profits either from higher prices or lower costs. The existence of efficiencies at least provides a procompetitive reason for parties to merge (although a merger can both lower costs and lead to higher prices).

Ultimately, XM and Sirius will have to articulate merger benefits that the two firms could not have achieved themselves as independent firms competing in the market

place. There appear to be plausible efficiencies that will be generated by the merger (e.g., elimination of duplicative programming, better spectrum and satellite utilization and savings in subscriber acquisition and other overhead). However, the parties' efficiencies story – even if it can be substantiated – may not be enough to justify the merger if the Antitrust Division and the FCC believe the relevant market is limited to satellite radio.

Finally, the ease with which new firms could enter the market will also be evaluated. In this case, there is a regulatory barrier to entry – an FCC license. However, even if additional licenses were available from the FCC, it appears unlikely that a new firm could enter the market and become a meaningful competitor within the two year period envisioned by the Guidelines; as the existing satellite companies have demonstrated, it is expensive and time-consuming to attract the content and customers necessary to develop a viable business in this industry.

Conclusion

A merger between XM and Sirius poses obvious competitive issues. On the one hand, the merger quite plausibly is a merger to monopoly in a satellite radio market. On the other hand, XM and Sirius will advance market definition arguments that, if supported by the evidence, provide sufficient legal basis to permit the merger to proceed. The best answer to the market definition question will be found in evaluating the real world factors that go into a marginal consumer's calculation of what he or she will pay for satellite radio. The evidence relevant to this evaluation will come from a variety of sources, including the parties' documents, past pricing behavior and an understanding of how and why consumers choose to spend their money on satellite radio.