Public Knowledge

Testimony of Gigi B. Sohn, President
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Before the
U.S. House of Representatives
Committee on the Judiciary
Antitrust Task Force

Hearing On:
"Competition and the Future of Digital Music"

Washington, DC
February 28, 2007

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Chairman Conyers, Ranking Member Smith and other members of the Committee, my name is Gigi B. Sohn. I am the President of Public Knowledge, a nonprofit public interest organization that addresses the public's stake in the convergence of communications policy and intellectual property law. I want to thank the Committee for inviting me to testify on the proposed merger of XM Satellite Radio and Sirius Satellite Radio.

Introduction and Summary

The merger of XM Satellite Radio and Sirius Satellite Radio presents a dilemma for public interest advocates. On the one hand, the only two providers of radio services via satellite, who have vigorously competed over the past five and a half years, are seeking to consolidate, immediately raising questions about the impact on prices and choice for consumers. On the other hand, this vigorous competition has led to a spending war for new and better programming, leaving both competitors weakened in a world where Internet radio, HD radio, cable radio and other multichannel music, entertainment and information services have become increasingly popular.

Some will say that XM and Sirius' current financial state is a problem of their own doing – that a service that was intended largely to provide an alternative for the strict playlists and over-commercialization of broadcast music radio spent lavishly and foolishly on radio personalities and major league sports. They will also say that allowing a merger is a government "bail-out." I agree with both of these statements. But I do not believe that is where the focus should be here.

Instead, the salient question for policymakers is this: if this merger is simply denied, will consumers be better off? Given the financial state of both companies, their stagnating customer base and the growing competition in the marketplace, it appears likely that in the absence of a merger, both services will continue to limp along instead of investing in new and diverse programming. Might it not be better for consumers to permit the merger under conditions that provide expanded programming and pricing choice along with temporary measures to keep prices in check? After a great deal of discussion with my public interest colleagues, former regulators and antitrust experts, I believe that the latter is the best course.

Thus, the XM and Sirius Satellite radio merger should be approved only if it is subject to the following three conditions:

- the new company makes available pricing choices such as a la carte or tiered programming.
- the new company makes 5% of its capacity available to non-commercial educational and informational programming over which it has no editorial control.
- the new company agrees not to raise prices for three years after the merger is approved.

Two other points warrant mention here. The first is our strong opposition to any merger condition involving any limitations on the ability of consumers to record these satellite radio services. Such a condition would be tantamount to repealing the Audio Home Recording Act, which specifically protects a consumer's ability to record digital music.

The second is to urge Congress and the FCC to permit satellite radio broadcasters to do more, and not less, local programming. Broadcasters' opposition to this merger and to satellite radio's provision of local traffic, weather and emergency information is not only incredibly hypocritical given their own current regulatory efforts to consolidate, but is anticompetitive in its own right. Even assuming that broadcasters take seriously their statutory duty to serve local communities with programming that serves their needs (and not just traffic and weather), there is no reason why, in 2007, *any* media service should have a government-granted monopoly over local programming.

Whether the Proposed Merger Would Survive Antitrust Scrutiny is a Close Call and Warrants Thorough Analysis

Let me say at the outset that I am not an antitrust expert. Luckily, I have several colleagues who are. After conferring with them, I can only conclude that the antitrust questions raised here are very complex and ultimately depend on information to which Public Knowledge does not have access.

Take, for instance, the critical question of what would be the relevant product market. If one views the relevant market solely as satellite delivered radio service, the proposed transaction could be characterized as a "merger to monopoly," which would strongly suggest outright rejection. Some of my public interest and academic colleagues, whom I respect enormously, do just that.[1]

On the other hand, if, as I believe, the market is defined more broadly to include a wide variety of radio, mobile, and multi-channel music services, a regulator might reach a very different result. Indeed, XM and Sirius' services overlap with and have effects on several different markets (including video, if you include their feeds of cable shows). Competitors in these markets would include over-the-air broadcast and HD radio, Internet radio services, cable (and DBS) radio, and wireless phone music and services like Sprint Radio, MobiTV, and V-Cast, as well as podcasts that can be downloaded onto MP3 players.

A more broadly-defined market would include all of the services to which consumers would readily turn if satellite radio prices were raised. Anecdotal evidence suggests that there is no shortage of substitutes. On the other hand, we cannot ignore the fact that there are real differences between satellite radio and its competitors.

For instance, an audiophile colleague of mine is puzzled over my love of satellite radio because he receives all the new music he wants (for free) from Internet radio. In addition to providing highly diverse and specialized programming, Internet radio is becoming more mobile, and as a result is becoming a viable competitor to satellite radio.[2]

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[1] For example, one analyst argues that if XM and Sirius did constitute an entire market, there should be evidence that they are engaging in oligopoly-like behavior, and reaping similar profits. The fact that they are both losing money suggests otherwise. Blair Levin, Rebecca Arbogast, & David Kaut, "XM-Sirius Review: Government Approval Close Call But More Likely Than Not", STIFEL NICOLAUS TELECOM, MEDIA & TECH Regulatory, Feb. 20, 2007.

[2] A number of mobile carriers are currently providing streaming audio, video, and data to the mobile phone handsets they sell, generally on an exclusive basis between the wireless and content providers. This content is provided to the subscriber for a fee, typically in addition to wireless data fees, as these services

However, wireless music and program services still may not have the higher-quality sound offered by HD or satellite radio. Podcasts, which many satellite consumers may consider an easy substitute for satellite programming, are provided via a "pull" technology, more akin to "on-demand," that the consumer picks and chooses, as opposed to satellite radio, which is a "push" technology in which the consumer has no choice over programming. And while broadcast radio is becoming a clear satellite competitor with multi-channel and with some commercial-free HD services, it is a local service that still hews to strict music playlists and is largely advertiser supported.[3] Of course, a product needn't be identical to be substitutable.[4] While intuitively it would seem that at least some of these competitors are substitutes, consumer data would be most helpful to answer this question.

In the end, whether or not the merger is approved should depend upon its effects for consumers and for the market. If, for instance, the merger increases net efficiencies through the sharing of expensive infrastructure, or if the merger prevents one company's assets from being lost altogether, then these factors would favor approval. We look forward to the antitrust authorities' thorough analysis of the merger's impact on consumers.

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are usually IP based. Verizon's VCast provides entertainment, sports, news, and weather video clips, music downloads, and mobile data; Verizon is also employing new MediaFLO technology to directly distribute content to handsets, apart from their data-based network. Clear Channel and MobiTV are exclusive providers of streaming audio and video content to Cingular subscribers. Sprint Mobile currently provides a number of streaming radio channels, from Music Choice, Rhapsody, Sprint Radio, and Sirius; it is also aiming to provide more competition for high-speed data and competitive video streaming with WiMax technology.

[3] As evidenced by its appearance here today and its immediate negative reaction to the merger announcement, there is little doubt that the broadcast industry views satellite radio as a substitute.

[4] United States v. E.I. du Pont de Nemours & Co., 351 U.S. 377, 394 (1956). Although each of these products differs in the technical and legal details of how a user receives audio content, the various products are still competitors to the extent that consumers could migrate from one to another due to a change in price.

The Proposed Merger Would be in the Public Interest if it is Subject to Conditions Which Promote Diversity, Preserve Consumer Choice and Keep Prices in Check

Should the merger survive antitrust scrutiny, the public interest would be served by permitting the merger subject to conditions that promote diversity, preserve consumer choice and keep prices in check.

I reach this conclusion for several reasons. First, over the past several years, both companies have consistently lost money and subscriber growth has slowed,[5] which makes it less likely that they will take a chance on alternative programming or programming provided to under-served communities. For example, in 2005 XM dropped almost all of its world music channels, including one channel devoted entirely to African music. Around the same time it dropped its more alternative Spanish music programming, opting for more popular Spanish fare. The high fixed costs of operating a satellite service will make it difficult for each service, with its relatively small subscriber base, to take chances on such programming and/or lower prices. Combining the subscriber base of the two companies would allow the new company to leverage those fixed costs more efficiently across that larger base, reducing the cost per subscriber and facilitating the purchase of new programming and/or lower prices.

Second, consumers would be served by gaining access to channels that they could not receive unless they subscribed to both services. No longer would a consumer have to choose between Major League Baseball and the National Football League, Martha Stewart and Oprah or National Public Radio and XM Public Radio (which features the

[5] *See, e.g.*, Craig Moffett, "XMSR and SIRI: Where to from here?" BERNSTEIN RESEARCH, Feb. 20, 2007, 8-13 (detailing loss in revenues and subscriber growth for both companies). *See also* Richard Siklos and Andrew Ross Sorkin, "Merger Would End Satellite Radio's Rivalry," N.Y. TIMES, *available at* http://www.nytimes.com/2007/02/20/business/media/20radio.html (noting combined $6 billion in losses and slower-than-expected growth).

still popular former NPR personality Bob Edwards). Moreover, to the extent that the new company will eliminate duplicative channels, there will be more capacity for new and diverse programming (which could even include video programming). In addition, as discussed below, we would urge the FCC to permit the new company to provide increased local programming, including news and public affairs, which would directly compete with over-the-air broadcast radio.

Even with these consumer benefits, the magnitude of this merger warrants strong protections that ensure greater program diversity, promote consumer choice and keep prices in check. Thus, the merger should only be approved subject to the following three conditions:

- *Consumer Choice.* The new company should make available to its customers either a la carte or tiered program choices. For example, the company could make a music tier or a sports tier available to consumers, which would cost less than subscribing to the entire service.

- *Non-commercial Set-Aside.* The new company should make available 5% of its capacity for noncommercial educational and informational programming over which it will have no editorial control. There is precedent for this kind of non-commercial set-aside. Section 335 of the Communications Act requires Direct Broadcast Satellite providers to "reserve a portion of its channel capacity, equal to not less than 4 percent nor more than 7 percent, exclusively for noncommercial programming of an educational or informational nature."[6] This would ensure a diversity of programming choices and would permit programmers that would not normally have access to a national service to do so. As with the DBS set-aside, the new company could not fill it with programmers already on its system, and no non-commercial programmer would be able to control more than one of these channels.

- *Three-Year Freeze on Price Increases:* Because some of the services that will compete with satellite radio are still nascent (such as mobile wireless entertainment), the new company should be prohibited from raising prices for three years after the merger is approved.

[6] 47 U.S.C. § 335(b)(1).

There is a belief among some of that if this merger is approved, then no other merger involving digital media will ever be denied. But that need not be the case if the antitrust authorities and the FCC are clear that the merger is being approved based upon very specific facts and circumstances. This merger involves a national service that has become a luxury item for less than five percent of Americans. As such, approval should have no impact on any questions about any proposed consolidation of local broadcasters.

This Merger Should Not Be Conditioned on any Limits on Consumers' Right to Record Satellite Radio

For the past 18 months, the recording industry and XM Satellite Radio have been engaged in a battle over whether XM should pay an extra licensing fee for selling a receiver that allows consumers to record blocks of programming and disaggregate it into individual songs. In the alternative, the recording industry has sought to have XM embed technological protection measures that would prohibit this activity. This dispute is the subject of an ongoing lawsuit in the Second Circuit[7] and pending legislation in the Senate.[8]

Public Knowledge is concerned that the recording industry will attempt to use the merger to limit consumers' ability to record satellite radio transmissions. Consumers have been permitted to record radio transmissions since the invention of the tape player, and that ability is specifically protected under the Audio Home Recording Act, 17 U.S.C. § 1001 *et seq*., which prohibits any copyright infringement action

> based on the manufacture, importation, or distribution of a digital audio recording device, a digital audio recording medium, an analog recording device, or an

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[7] *See* Atlantic Recording Corp. v. XM Satellite Radio, Inc., No. 06 Civ. 3733 (S.D.N.Y. Jan. 19, 2007).
[8] S. 256, the Platform Equality and Remedies for Rights Holders in Music (PERFORM) Act of 2007.

> analog recording medium, or *based on the noncommercial use by a consumer of such a device or medium for making digital musical recordings or analog musical recordings.*

Emphasis added.

The record companies have questioned whether the Audio Home Recording Act is in need of revision and repeal in light of changing technologies. While this might be a legitimate question, the place to ask that question is before Congress, not in the context of a merger. Moreover, to the extent that such a condition might be sought at the FCC, the federal courts have already ruled that the Commission has no power to require particular technological design mandates in the absence of express Congressional authority. *Am. Library Assoc. v. FCC*, 406 F.3d 689 (D.C. Cir. 2005). Nor does the FCC have the power to require XM to pay a licensing fee in exchange for the ability to sell such receivers.

The Broadcast Industry's Opposition to the Merger is Hypocritical and Anticompetitive

Moments after the proposed merger of XM and Sirius was announced, the National Association of Broadcasters announced its intention to oppose it. The trade association said it would be "shocked if federal regulators permitted a merger of XM and Sirius," and that permitting such a merger, because it is in part based on the financial condition of the companies, would be akin to "a government bail-out to avoid competing in the marketplace."

There are many delicious ironies in this statement,[9] but perhaps the most salient to this discussion is that as we speak, the broadcast industry is seeking FCC relief in order

[9] See http://www.publicknowledge.org/node/836.

to consolidate. And perhaps the primary rationale for requesting that relief is the supposedly uncertain and deteriorating financial state of the broadcast industry.[10]

It is no secret that the broadcast industry is opposing this merger for the purpose of obtaining conditions that would further limit satellite radio from providing local programming, including weather, traffic and emergency information. Indeed, it has recently renewed an effort to get Congress to place such limits on satellite radio.[11] In other words, in order to save local radio, the NAB seeks to prohibit more local radio.

Any conditions on the merger that would limit satellite radio from providing local programming would be profoundly anticompetitive, and should be rejected. Setting aside the question of whether "local" broadcasters take seriously their responsibility of serving their local communities with news and public affairs programming (not just traffic and weather), there is no rationale for shielding broadcasters from competing for local viewers and listeners. Indeed, rather than limit such competition, Congress and/or the FCC should permit satellite radio and other national services to provide more, and not less, local programming.

Conclusion

The proposed merger of XM Satellite Radio and Sirius Satellite Radio raises complex antitrust questions. If these questions are resolved in favor of the merger, Public

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[10] *See, e.g.*, Shira Ovide, "Clear Channel's Profit Declines 54%" WALL STREET JOURNAL, Feb. 24, 2007 at A6; Associated Press, "Earnings Prieview: CBS Corp," *available at* http://www.chron.com/disp/story.mpl/ap/fn/4583381.html, Feb. 26, 2007 (noting losses in the "troubled radio unit," apparently caused by "stagnation in the overall radio market"); Comments of the National Association of Broadcasters, FCC Quadrennial Ownership Review, MB Docket No. 06-121 (Filed Oct. 23, 2006) 29-35 *available at* http://www.nab.org/Content/ContentGroups/Legal/Filings/2006/QuadrennialOwnership2006Final.pdf ("In sum, the combination of competition from cable, satellite, the Internet and other digital technologies is forcing broadcasters to fight even harder in the advertising marketplace.").

[11] See H.R. 983, the "Local Emergency Radio Service Act of 2007".

Knowledge believes that with conditions that protect consumer choice, promote diverse programming and keep prices in check, the transaction is in the public interest. I would like to thank the Committee again for inviting me to testify and I look forward to any questions you might have.