SIMPSON THACHER

REPORT FROM WASHINGTON

The Department of Justice Gives Unconditional Approval to Proposed Merger of Sirius and XM

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TO VIEW THE STATEMENT OF THE DEPARTMENT OF JUSTICE ANTITRUST DIVISION ON ITS DECISION TO CLOSE ITS INVESTIGATION OF XM SATELLITE RADIO HOLDINGS INC.'S MERGER WITH SIRIUS SATELLITE RADIO INC., PLEASE CLICK HERE.

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The Antitrust Division of the Department of Justice (the "DOJ") yesterday granted unconditional antitrust clearance to the proposed merger of Sirius and XM, the only two satellite radio providers. The DOJ explicitly rejected claims that the merger would create an anticompetitive monopoly and instead concluded that the merger may benefit consumers through lower prices.

The announcement ends a thirteen-month investigation that drew significant attention from a number of industry players – in particular, the terrestrial radio broadcasters – that actively campaigned against the merger. Although the merger still awaits approval from the Federal Communications Commission (the "FCC"), the DOJ's decision represents a significant milestone in the parties' efforts to obtain regulatory approval.

DOJ CLEARANCE

The DOJ focused its analysis on the competitive effects in each of the two primary distribution channels for satellite radio service – original equipment manufacturer ("OEM") and retail. Regardless of channel, the DOJ found through its data analysis that customers rarely switch between Sirius and XM, consistent with the bottom-line conclusion that competition between the two providers is limited.

Sirius and XM distribute their receivers through car manufacturers that install satellite radio equipment directly into new cars, and this channel (known as OEM) accounts for the predominant and growing share of new satellite radio subscriptions. The DOJ found that significant competition between the parties would not occur for many years since the competitive terms governing these arrangements are subject to existing sole-source contracts that will remain in effect through 2012 or beyond.

Sirius and XM also distribute their products through mass market retail distribution. While acknowledging that retail channel sales have plummeted since

2005 and that the parties projected this decline to accelerate, the DOJ identified retail as an arena where the parties might compete directly in a significant fashion in the future. The DOJ nevertheless concluded the merger would not cause anticompetitive effects in the retail channel.

In support of its conclusion, the DOJ cited a series of factors identified by the parties that indicated the transaction was unlikely to facilitate anticompetitive conduct post-merger in the retail channel. As an initial matter, the DOJ stated that, today, even absent the merger, Sirius and XM do not compete with each other for large segments of retail customers because they offer different and exclusive programming options. The DOJ noted that a potential customer considering XM to listen to Major League Baseball or Sirius to listen to Howard Stern would not consider the other radio service to be an attractive option. Additionally, the DOJ found that many retail customers are buying additional receivers to add to an existing automobile subscription, and thus would not respond to a price increase by choosing the other satellite radio provider's services given their preference for alternative audio entertainment offerings. After excluding these segments of the actual and potential retail subscriber base, the DOJ found that "the evidence did not demonstrate that the number of current or potential customers that view XM and Sirius as the closest alternatives is large enough to make a price increase profitable." The DOJ also explained that the parties could not identify and price discriminate against those actual or potential customers who might see the services as the two closest substitutes.

The DOJ also credited a number of other important arguments proffered by the parties. First, the companies' consumers enjoy a number of non-satellite alternatives, such as traditional AM/FM radio, HD Radio, MP3 players, and audio offerings delivered through wireless offerings. Second, in the future, consumers would benefit from additional audio entertainment options since technological changes, including formats that are under development, are likely to make alternatives to satellite increasingly attractive over time. Finally, and perhaps most significantly, the DOJ concluded that the significant variable and fixed cost savings that the parties anticipate realizing through the merger "alone likely would be sufficient to undermine any inference of competitive harm."

IMPLICATIONS

The DOJ's explicit acknowledgement of merger-related efficiencies as a sufficient justification, even setting aside other arguments, for approving the transaction is one of the most interesting developments in merger review in the United States. Under the Horizontal Merger Guidelines, neither the DOJ nor the Federal Trade Commission will "challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant market." However, in practice, both agencies have been reluctant to grant regulatory approval on the basis of potential merger-related efficiencies, and few merging parties have satisfied the agencies' stringent standard. The DOJ's acknowledgment that it would have been willing to approve the transaction on the basis of such efficiencies underscores the significance of the specific and substantial synergies that the parties convincingly were able to present.

Simpson Thacher advised Sirius in the antitrust and corporate aspects of its merger with XM.

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