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May 10, 2011

The Honorable Herb Kohl
United States Senator
Chairman,
Subcommittee on Antitrust,
Competition Policy and Consumer Rights
Judiciary Committee
330 Hart Senate Office Building
Washington, DC 20510

The Honorable Mike Lee
United States Senator
Ranking Member,
Subcommittee on Antitrust,
Competition Policy and Consumer Rights
Judiciary Committee
825 Hart Senate Office Building
Washington, DC 20510

Re: May 11, 2011 Hearing: "The AT&T/T-Mobile Merger: Is Humpty Dumpty Being Put Back Together Again?"

Dear Chairman Kohl and Ranking Member Lee,

Thank you for holding the very important and timely hearing on AT&T's proposed acquisition of T-Mobile USA. As the subcommittee conducts its oversight of this unprecedented transaction, Free Press[1] urges members to focus on the underlying facts and to work to ensure that consumer concerns are placed above all others.

The Department of Justice's own guidelines and past precedent make it quite clear that this merger raises such concerns about competition that it must be rejected. Just as putting Humpty Dumpty back together again in the nursery rhyme was impossible, the approval of this transaction is inconceivable.

As we outline in this letter, the available evidence demonstrates:

- The relevant product market is the nationwide post-paid smartphone cellular service market.
- The market is already highly concentrated, and AT&T's proposed acquisition of T-Mobile would result in the re-formation of a tight duopoly in wireless service.
- This merger would result in substantial unilateral harms to consumers and competition.

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[1] Free Press is a national, nonpartisan organization with more than 500,000 members working to increase informed public participation in media and communications policy debates. Our members have raised numerous concerns about this merger and its impact on the wireless Internet market.

- The market is particularly vulnerable to coordinated conduct, and this merger would further exacerbate that harm.
- There is no prospect of competitive entry that could mitigate the unilateral harms and coordinated effects of this transaction.
- The claimed efficiencies of this merger are speculative, non-merger specific, non-cognizable, and would not outweigh the adverse competitive impact of this transaction.
- Local market divestiture would not remedy the adverse competitive impacts that this transaction will have on the nationwide product market.

We believe that the analysis conducted by the Department of Justice ("DOJ" or "Department") will affirm these conclusions. Once they do, we hope that policymakers will work to ensure that Americans finally get the benefits of meaningful competition in the wireless market. Americans need real competition *and* advanced wireless services, and should not be asked to trade one for the promise of the other.

THE RELEVANT PRODUCT MARKET IS THE NATIONWIDE POST-PAID SMARTPHONE CELLULAR SERVICE MARKET

AT&T's proposed acquisition of T-Mobile USA is a massive horizontal merger that would combine the operations of the nation's second- and fourth-largest cellular service providers. The DOJ has already taken initial steps to scrutinize this proposal, issuing further information requests to the merging parties and sending civil investigative demands to their competitors.[2] As the DOJ further considers the merger application, one of its first tasks will be to define the relevant product market, and also to define the geographic market.

While at the highest level, this merger involves the combination of two companies that operate in the broad "cellular" market, we believe that the data demonstrates that the most relevant product market that would be affected by this transaction is the nationwide, post-paid smartphone cellular service market.

First, the available evidence indicates that there is a clear market boundary between the pre-paid, no-contract cellular services offered by companies like Tracfone or Leap Wireless, and the post-paid, contract services sold by carriers like AT&T or T-Mobile. The monthly retail prices for post-paid services are substantially higher than those for pre-paid services. The available devices are far more limited with pre-paid services than with post-paid services.[3] The companies that offer both pre- and post-paid services view these offerings as non-competitive

[2] "Justice Department Said to Extend Look at AT&T T-Mobile Bid," Sara Forden and Todd Shields, *Bloomberg*, May 3, 2011.

[3] For example, AT&T's website currently lists 35 different smartphones for sale, while no-contract pre-paid carrier MetroPCS' website lists just six.

and in separate markets.[4] And pre- and post-paid carriers target different market demographic segments, with pre-paid carriers particularly focused on younger, lower-income customers that lack a satisfactory credit history.[5] There is simply no evidence to suggest that the hypothetical monopolist test used by the Department in its analysis would show that a small but significant and non-transitory increase in price ("SSNIP") would result in a critical level of customers substituting post-paid for pre-paid services.[6] Indeed, the prices of the unlimited talk, text and data plans of the post-paid carriers are already nearly twice that of the pre-paid carriers,[7] yet post-paid subscriber gains continue to outpace pre-paid gains.[8]

Second, while the merging parties offer several cellular services (e.g. voice only or data only) in competition with other carriers, the available evidence indicates that there is a separate and distinct market for smartphone cellular service.[9] Approximately one-third of mobile subscribers currently use a smartphone,[10] but analysts estimate that by the end of the decade, smartphones will be in use by nearly the entire retail subscriber base.[11] When defining the

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[4] For example, AT&T has been explicit about viewing its own "GoPhone" pre-paid service as a separate and distinct offering that does not compete against its own post-paid services. Richard G. Lindner, AT&T's chief financial officer, told investors in 2009: "With respect to GoPhone and prepaid results for the quarter, prepaid results were weaker for the quarter. Obviously we had a net loss of customers of about 400,000. We had lower churn year over year, and we've been working to bring churn down and we're seeing some benefits there. But the impact was more on the gross sales side, and certainly we're seeing impacts from other competitive offers in the market… But one thing that I think we feel is important is we're not going to put offers in the market that we don't feel will be profitable or earn a reasonable return. And we won't do anything obviously that would impact or cannibalize our postpaid base." *See* "Transcript of AT&T Inc.'s Q2 2009 Earnings Call on 07/23/2009."

[5] For example, pre-paid carrier Leap Wireless has stated that its "target customers [are] young, ethnically diverse and in households typically making less than $50,000 a year." *See* "Leap 2008 Annual Review: CEO Letter."

[6] *See* "Horizontal Merger Guidelines," Department of Justice and Federal Trade Commission, August 19, 2010 (*Horizontal Merger Guidelines*), at 8. "The Agencies employ the hypothetical monopolist test to evaluate whether groups of products in candidate markets are sufficiently broad to constitute relevant antitrust markets… The hypothetical monopolist test requires that a product market contain enough substitute products so that it could be subject to post-merger exercise of market power significantly exceeding that existing absent the merger. Specifically, the test requires that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future seller of those products ('hypothetical monopolist') likely would impose at least a small but significant and non-transitory increase in price ('SSNIP') on at least one product in the market, including at least one product sold by one of the merging firms… The SSNIP is employed solely as a methodological tool for performing the hypothetical monopolist test; it is not a tolerance level for price increases resulting from a merger."

[7] Verizon Wireless offers an unlimited talk, text and data plan for $119.98 per month (plus taxes and fees) versus MetroPCS' unlimited talk, text and data offering for $60 per month.

[8] During 2010, total U.S. pre-paid subscriptions increased by 3.88 million versus an increase of 4.71 million post-paid subscriptions. *See* SNL Kagan, *Wireless Industry Benchmarks*.

[9] Smartphone service consists of a monthly plan that offers both voice and data access through a handheld device capable of traditional telephone calls and other multimedia activity including Internet access and the running web-connected applications.

[10] *See* "State of the Media, Mobile Usage Trends: Q3 and Q4 2010," *Nielsen*, April 2011.

[11] *See* Sharon Armbrust, "US carrier CapEx spend in the midst of a decade-long ramp," *SNL Kagan*, February 28, 2011. ("SNL Kagan estimates that wireless subscriptions, including connected devices, hit 97% penetration of the

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boundaries of the relevant product market, the DOJ will investigate how and to what extent consumers can and would substitute other products in response to price increases in the candidate market.[12] For smartphone consumers, there are no viable substitutes for all-in-one mobile telephony and computing. A smartphone consumer facing sustained price increases in the market controlled by the hypothetical monopolist has no choice but to pay the increased rate or exit the market to voice-only services and PC-facilitated computing via fixed telecommunications networks, and most would not. Moreover, in the post-paid smartphone market (where the bulk of smartphone subscriptions are), consumers are locked into long-term contracts with substantial early termination penalties; for these consumers, exit is a very costly option.[13] These high costs, which include not only termination fees but also the need to purchase a new device, mean that switching *within* the market to another carrier is also prohibitive. The ability for the hypothetical monopolist to target the post-paid smartphone subset of customers and impose a SSNIP means that the relevant product market definition is narrower than the broader "cellular" market.[14]

Third, the available evidence indicates that the services offered by carriers with a national footprint are now in a separate and distinct market from those offered by regional carriers, and this differentiation will only increase as smartphones utilizing so-called 4G network technologies become the dominant cellular product. In 2010, during a period when both AT&T and Verizon Wireless raised prices and reduced choice for consumers,[15] they still managed to increase their

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U.S. population as of year-end 2010. And we expect smartphones to be in use by 93% of the retail subscriber base by the end of this decade.")

[12] *See Horizontal Merger Guidelines* at 11. ("In considering customers' likely responses to higher prices, the Agencies take into account any reasonably available and reliable evidence, including, but not limited to: ...objective information about product characteristics and the costs and delays of switching products, especially switching from products in the candidate market to products outside the candidate market...").

[13] Exit from the post-paid market involves not only costs in the form of early termination penalties, but also results in lower consumer utility as consumers must substitute the convenience of all-in-one ubiquitous connectivity for other more cumbersome and expensive methods.

[14] *See Horizontal Merger Guidelines*, at 12. "If a hypothetical monopolist could profitably target a subset of customers for price increases, the Agencies may identify relevant markets defined around those targeted customers, to whom a hypothetical monopolist would profitably and separately impose at least a SSNIP. Markets to serve targeted customers are also known as price discrimination markets. In practice, the Agencies identify price discrimination markets only where they believe there is a realistic prospect of an adverse competitive effect on a group of targeted customers."

[15] In early 2010, Verizon implemented an effective price increase by forcing all customers of feature and smartphones to purchase a data plan. AT&T shortly followed suit. Also in 2010, AT&T eliminated its unlimited data plan for smartphones, forcing new customers into capped plans with overage charges. *See e.g.* Karl Bode, "Verizon Announces Wireless Pricing Changes," *DSLReports*, Jan 15, 2010. ("The biggest news of course is that Verizon's 25 megabyte for $9.99 per month plan (the one we're sure Verizon makes the most money from) is now mandatory for all of Verizon's '3G Multimedia' phones.). *See also e.g.* Marguerite Reardon, "AT&T-Verizon price war debunked (FAQ)," *CNET News*, Jan 20, 2010. ("In fact, both AT&T and Verizon Wireless are extending data plans to a whole slew of customers who formerly were not subscribing to any data plans. And it is likely these are the customers who will see a bigger phone bill when they upgrade their phones or renew their contracts."). *See also e.g.* Jeffry Bartash, "AT&T to end unlimited plans for wireless data," *MarketWatch*, June 2, 2010.

subscriber totals while most other post-paid carriers, regional and national, lost subscribers.[16] The top four carriers (Verizon, AT&T, Sprint and T-Mobile) are the only post-paid providers offering post-3G quality data services (HSPA+, LTE or WiMax), and the depth and quality of their smartphone portfolios are far superior to those of the regional carriers. Indeed, these four carriers controlled 94 percent of all cellular market revenues in 2010, and their share of smartphone revenues is likely higher.[17] This trend is expected to continue, particularly concentrating subscribers and revenues at the very top between AT&T and Verizon. While the regional carriers had more consumer relevance a decade ago, it is clear that today's market is a national market.[18]

With the relevant product market appropriately defined as the nationwide post-paid smartphone cellular service market, the harms of this merger will be impossible to ignore.[19] The Department's analysis of the evidence will surely show that substitution for pre-paid and regional carriers will not be substantial enough to prevent abuses of market power in the national post-paid market.[20]

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[16] In 2010, Verizon Wireless added 2.6 million post-paid subscribers while AT&T added 3.4 million. However, regional carrier Cincinnati Bell lost 28,000 post-paid subscribers, and other major regional carriers NTELOS and Atlantic-TeleNetwork saw no growth or end-of-year subscriber losses. US Cellular, a post-paid carrier that uses roaming agreements to offer national coverage, lost 66,000 subscribers. In 2010, Sprint lost 855,000 subscribers, and T-Mobile lost 390,000. *See* SNL Kagan, *Wireless Industry Benchmarks*.

[17] *See* SNL Kagan, *Wireless Industry Benchmarks*.

[18] In 2001, most of the wireless market consisted of regional carriers that in some cases offered nationwide service through roaming agreements. Since then, the major national carriers have gone on a buying spree, building a nationwide footprint through mergers and acquisitions and turning the market from regional to national. In 2001, the top two cellular providers controlled 43 percent of all subscriptions, compared with 65 percent at the end of 2010.

[19] Though there is ample evidence to define the market as the nationwide post-paid smartphone cellular service market, the domination of the top four carriers of the overall cellular market is so extensive that including pre-paid carriers and all subscriptions into the antitrust analysis would not impact the conclusions about harmful unilateral effects and coordinated behavior.

[20] The question of geographic market boundaries will be important to consider, but given the fundamental shift of the wireless market from a regional to national carrier market, this consideration becomes less relevant, as the harms from the merger will be national, not local. Certainly consumers' buying decisions in this market are influenced by what services are available in the geographic area where they live and work, but supplier behavior is solely at the national level. Data plans are priced nationally regardless of the level of local competition. Smartphone devices are procured and introduced to the national market, not regionally. And there is no geographic characteristic to innovation in the wireless market; the harms to innovation from unilateral and coordinated effects will be felt nationally, regardless of what individual carrier choices a consumer has in a given local market. Indeed, the DOJ has in the past recognized the difference in local purchasing markets and the impact of mergers in broader markets: "The existence of local markets does not preclude the possibility of competitive effects in a broader geographic area, such as a regional or national area…" *See* United States, State of Alabama, State of California, State of Iowa, State of Kansas, State of Minnesota, State of North Dakota, and State of South Dakota v.Verizon Communications Inc. and Alltel Corp., *Competitive Impact Statement*, October 30, 2008.

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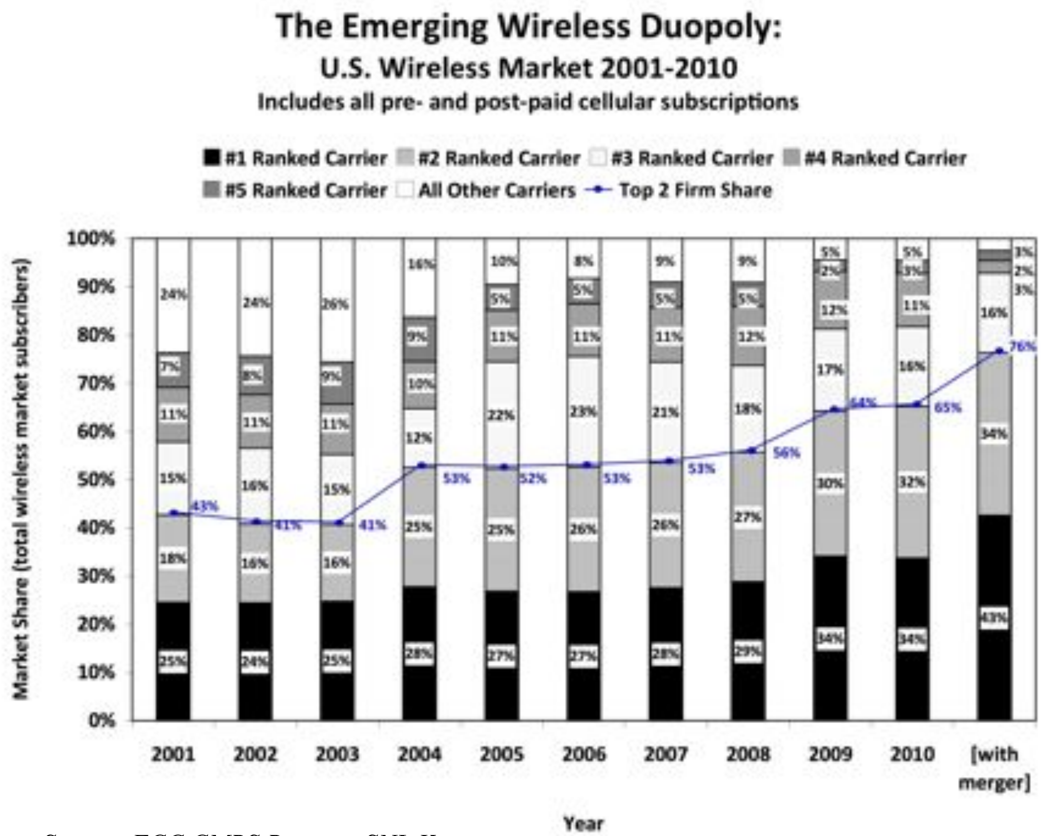
THE RELEVANT PRODUCT MARKET IS ALREADY HIGHLY CONCENTRATED, AND AT&T'S PROPOSED ACQUISITION OF T-MOBILE WOULD RESULT IN THE RE-FORMATION OF A TIGHT DUOPOLY IN WIRELESS SERVICE

The U.S. wireless market is highly concentrated, and has over the past decade transformed from a market dominated at a regional level by a handful of carriers, to a market dominated at a national level by just two companies -- AT&T and Verizon Wireless. In 2001, the top two carriers' share of total U.S. wireless subscriptions was 43 percent. By the end of 2010, this two-firm share rose to 65 percent, and will be close to 80 percent if AT&T is allowed to take over T-Mobile (see Figure 1). During this same period, as the large national carriers began creating a true national footprint through mergers and acquisitions of smaller regional companies, the share of subscriptions outside the top five carriers shrunk from 24 percent to 5 percent (see Figure 1).

Figure 1:



Source: FCC CMRS Reports; SNL Kagan

This domination at the top has only been exacerbated by the trend toward data-connected smartphones and the concentration of prime spectrum, backhaul and handset-buying power between AT&T and Verizon. The top four carriers captured 94 percent of the total cellular market revenue in 2010.[21] Verizon and AT&T together accounted for 67 percent of the total cellular market revenue, despite controlling 65 percent of all mobile subscriptions.[22] And while Verizon and AT&T saw substantial subscription growth in 2010, most other post-paid carriers lost customers.[23]

This concentration of customers and revenues at the top is not the result of price competition, as AT&T and Verizon both implemented effective price increases in 2010,[24] while carriers with lower-priced offerings continued to lose market share.[25] Indeed, Verizon and AT&T's wireless profit margins dwarf those earned by pre-paid and other post-paid carriers.[26]

The domination of the market at the top is a strong indicator of a broken market, one that the proposed acquisition of fourth-place carrier T-Mobile by AT&T would only exacerbate.[27] The proposed concentration of nearly 80 percent of the market between two carriers, with only one remaining company with double-digit shares, will have a particularly corrosive impact on innovation and what remains of competitive incentives.[28] The lower cost offerings from the other two major national post-paid carriers have made no impact on AT&T's or Verizon's ability to grow revenues, subscribers, margins, or market share.[29]

That AT&T and Verizon were already able to implement effective price increases relative to other carriers while still growing share, margins and subscribers is a strong indicator of the existing lack of competition. Indeed, the *Horizontal Merger Guidelines* state:

> If a firm has retained its market share even after its price has increased relative to those of its rivals, that firm already faces limited competitive

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21 *See* SNL Kagan*, Wireless Industry Benchmarks*.

22 *See* SNL Kagan*, Wireless Industry Benchmarks*.

23 *Supra* note 16.

24 *Supra* note 15.

25 AT&T and Verizon's combined share of subscribers was 64 percent at the end of 2009 and 65 percent at the end of 2010.

26 For example, in 2010, Verizon's average Wireless EBITDA margin was 47 percent while AT&T's was 41 percent. By contrast, Sprint's average Wireless EBITDA was 18 percent; U.S. Cellular's was 20 percent; Leap Wireless' was 21 percent; and T-Mobile's was 29 percent. *See* John Fletcher, "Verizon Wireless: The best spectrum, wireless EBITDA," *SNL Kagan*, March 16, 2011.

27 As is noted in the *Horitontal Merger Guidelines*, "even a highly concentrated market can be very competitive if market shares fluctuate substantially over short periods of time in response to changes in competitive offerings." (p. 18). However, this is not the case in the U.S. wireless market, with Verizon and AT&T steadily growing their share through mergers, acquisitions, and capturing of customers from other carriers.

28 *See Horizontal Merger Guidelines*, at 15. "Market shares can directly influence firms' competitive incentives. For example, if a price reduction to gain new customers would also apply to a firm's existing customers, a firm with a large market share may be more reluctant to implement a price reduction than one with a small share. Likewise, a firm with a large market share may not feel pressure to reduce price even if a smaller rival does."

29 *Supra* notes 15 and 26.

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> constraints, making it less likely that its remaining rivals will replace the competition lost if one of that firm's important rivals is eliminated due to a merger.[30]

T-Mobile has focused on earlier rollout of higher quality HSPA+ data services at substantially lower prices than the other major national carriers. Its elimination from the marketplace would further cement the division between the pre- and post-paid markets and remove a major source of what little pricing discipline currently exists on AT&T and Verizon.

AT&T'S ACQUISITION OF T-MOBILE WOULD RESULT IN SUBSTANTIAL UNILATERAL HARMS IN THE RELEVANT PRODUCT MARKET

Though the proposed merger is not a merger to monopoly, there would nonetheless be substantial unilateral harms in the national post-paid smartphone cellular service market. These harms include relative reduced capital investment, reduced innovation, higher prices of certain specific services, and removal of certain products from the market.

First, one of the stated purposes of the transaction is AT&T's desire to reduce capital investments after it acquires T-Mobile's tower infrastructure -- capital investments it certainly would otherwise make.[31] This artificial reduction of efficient capital investment essentially means that a major motivation behind the merger is nothing more than an output suppression strategy. The Department considers any action to refrain from building or buying capacity that would have otherwise been obtained to be an output suppression strategy.[32] This unilateral output suppression strategy would be profitable for AT&T, as post-merger it would control a substantial portion of the smartphone service market;[33] its competitors would be unlikely to have a non-trivial supply response; the incremental margins earned on the capital investment would have been low; and the elasticity of demand for smartphone cellular service would be low.[34] Indeed,

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[30] *See Horizontal Merger Guidelines*, at 18.

[31] This includes the deployment of fiber optic infrastructure to towers currently served by copper circuits, the upgrading of towers to HSPA+ or LTE, cell splits, the purchasing of excess capacity from competing carriers, and most importantly, more rapid deployment utilizing AT&T's immensely valuable but unused AWS and 700 MHz spectrum.

[32] *See Horizontal Merger Guidelines*, at 22. "A firm may leave capacity idle, refrain from building or obtaining capacity that would have been obtained absent the merger, or eliminate pre-existing production capabilities."

[33] While the smartphone subscriber counts are not publicly available, other data indicates that this market is even more top-heavy than the broader mobile market. AT&T has publicly stated that it has "twice as many smartphone users… as any other U.S. carrier." Thus, given that post-merger AT&T would have a 43 percent share of the entire pre- and post-paid mobile market, it is possible that AT&T's share of the smartphone market following this merger would exceed 50 percent. *See* "AT&T to Offer iPhone 3G S on June 19," *PR Newswire*, June 8, 2009.

[34] *See Horizontal Merger Guidelines*, at 23. "A unilateral output suppression strategy is more likely to be profitable when (1) the merged firm's market share is relatively high; (2) the share of the merged firm's output already committed for sale at prices unaffected by the output suppression is relatively low; (3) the margin on the suppressed output is relatively low; (4) the supply responses of rivals are relatively small; and (5) the market elasticity of demand is relatively low."

AT&T appears be paying a "kill off the competition" premium, as the $39 billion this transaction would cost them likely far exceeds the value of incremental capital investment that both AT&T *and* T-Mobile would need to make to deploy high-quality universal mobile data networks.

Second, while innovation in the mobile wireless industry is currently limited due to the lack of adequate competition, the elimination of T-Mobile would both remove a firm with a decent track record of product innovation and would reduce AT&T's incentive to innovate.[35] T-Mobile's ability to fully enter the market and compete effectively with AT&T and Verizon has been hampered by the Baby Bells' market power and legacy monopoly advantages, including their dominance of the special access and enterprise transit markets as well as their ability to lock in exclusive deals for the most popular handsets. But T-Mobile has taken on the role of a maverick competitor, using product innovation to differentiate and compete. T-Mobile was the first carrier to offer the now market-leading Android platform. T-Mobile also has a track record of offering its customers innovative service packages, including in-home service and discounts for customers who do not purchase subsidized handsets. T-Mobile also upgraded capacity at its towers and deployed the more robust HSPA+ cellular standard long before AT&T began its upgrades to this "3.5G" technology. The loss of this innovation competition along with the concentration of nearly 80 percent of the broader cellular market in the hands of the former Bell companies should be cause for concern at the DOJ.

Third, given that this merger is truly a merger to monopoly in the U.S. GSM-cellular standard market, it would have a substantial negative impact on handsets and service plans. AT&T would be the only U.S. buyer of GSM handsets, and the abuse of this monopsony power could result in poor quality and choice in devices. AT&T's monopoly over the GSM standard, which is used in most other foreign countries, could also result in higher international service plan prices.

Fourth, it is very likely that AT&T would reduce the total number of handsets available to customers of the combined firm.[36] Currently, AT&T's product inventory consists of 85 handsets while T-Mobile offers 60, with an overlap of just 13 devices.[37] It is highly likely that AT&T would remove many popular handset offerings, and in the future would be less likely to bring an innovative but risky GSM handset to market. This removal of popular handsets, along

[35] *See Horizontal Merger Guidelines*, at 23. "The Agencies may consider whether a merger is likely to diminish innovation competition by encouraging the merged firm to curtail its innovative efforts below the level that would prevail in the absence of the merger. That curtailment of innovation could take the form of reduced incentive to continue with an existing product-development effort or reduced incentive to initiate development of new products."

[36] *See Horizontal Merger Guidelines*, at 24. "If the merged firm would withdraw a product that a significant number of customers strongly prefer to those products that would remain available, this can constitute a harm to customers over and above any effects on the price or quality of any given product." Example 21 in the *Horizontal Merger Guidelines* is particularly apt here.

[37] *See* Sascha Segan, "My Letter to the FCC About AT&T-Mobile: Time to Submit Yours," *PCMag.com*, May 3, 2011.

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with the removal of certain popular service plans like the "Even More Plus" offering, should raise concerns with regulators.[38]

AT&T'S ACQUISITION OF T-MOBILE WOULD FURTHER EXACERBATE HARMFUL COORDINATED EFFECTS IN THE RELEVANT PRODUCT MARKET

There is already evidence that AT&T and Verizon benefit from coordinated interaction, and this merger would only exacerbate this harmful behavior. While assessing the potential for coordinated interaction is inherently a predictive exercise for the Department, the structure of the wireless marketplace is such that it is particularly vulnerable to this behavior. First, the product market (smartphone service plans) is largely homogeneous, with prices easily observed by competing firms (carriers rarely offer new customer discounts or retention incentives unlike in the wired broadband market, and price their services nationally).[39]

Because of handset exclusivity, two-year contracts, high early-termination fees, lack of handset portability, and a switching customer's need to repurchase applications, it is unlikely that a firm exercising market power through increased prices would immediately lose a substantial portion of customers to competing carriers.[40] Indeed, as stated above, AT&T and Verizon continue to see the greatest gains in subscribers despite substantially higher prices and recent effective price increases. In most markets, the impact of coordination would be greatly reduced by smaller firms expanding output and capturing share.[41] But the smartphone cellular service market is not a typical market: Smaller firms cannot rapidly expand their sales due to handset exclusivity, other switching costs and the lack of beachfront spectrum. Thus, the structure of the wireless market makes it particularly vulnerable to coordinated interaction.

This market is also particularly vulnerable to coordinated conduct because it is so top-heavy, with much of the subscriber base and revenues already concentrated between two firms (currently two-thirds, and four-fifths post-merger). Because of this duopoly, the harms from

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[38] T-Mobile's "Even More Plus" plans offer customers lower-priced, contract-free subscriptions if the customer brings their own GSM handset to the network, or purchases an un-subsidized handset from T-Mobile. None of the other major U.S. carriers offer this kind of European-style "BYOD" (bring your own device) plan.

[39] *See Horizontal Merger Guidelines*, at 26. "A market typically is more vulnerable to coordinated conduct if each competitively important firm's significant competitive initiatives can be promptly and confidently observed by that firm's rivals. This is more likely to be the case if the terms offered to customers are relatively transparent. Price transparency can be greater for relatively homogeneous products."

[40] *See Horizontal Merger Guidelines*, at 26. "A market is more apt to be vulnerable to coordinated conduct if the firm initiating a price increase will lose relatively few customers after rivals respond to the increase."

[41] *See Horizontal Merger Guidelines*, at 26. "This collective market power is diminished by the presence of other market participants with small market shares and little stake in the outcome resulting from the coordinated conduct, if these firms can rapidly expand their sales in the relevant market." But as mentioned above, the smaller regional and pre-paid firms are simply unable to rapidly expand sales, both due to supply (prime spectrum) and demand (switching costs) constraints.

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coordination would be substantial even if most firms do not engage in the behavior.[42] Further, because demand elasticity for service is relatively low, the coordinated behavior will be more profitable, increasing the likelihood of such harms post-merger.[43]

Indeed, while this merger would exacerbate pressures for the top firms to engage in coordinating behavior, it is apparent that such activity is already occurring. The high pre-merger margins earned by AT&T and Verizon relative to all other national and regional (pre- or post-paid) carriers is strong evidence of existing coordination.[44] It is an open secret (and preference) among Wall Street analysts that the top carriers are careful to avoid setting off any price wars.[45] That this merger would eliminate a maverick competitor and lead to "a more stable pricing environment" has been one of the main selling points of this transaction on Wall Street.

THERE IS NO PROSPECT OF COMPETITIVE ENTRY THAT COULD MITIGATE AGAINST THE UNILATERAL HARMS AND COORDINATED EFFECTS RESULTING FROM AT&T'S ACQUISITION OF T-MOBILE

Horizontal mergers of this size raise particular concern in markets where competitors are unable to enter sufficiently and quickly. In the wireless market, particularly the data market, sufficient new entry is impossible, and the smaller firms lack the ability to quickly and efficiently expand output at levels needed to offset the unilateral and coordinated harms.

No firm has entered the cellular telephony and data market in the past decade, and with the massive amount of consolidation, many have exited.[46] This lack of successful entry, combined with *increasing* margins[47] is a strong indicator that market entry is incredibly

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42 *See Horizontal Merger Guidelines*, at 26. "Coordinated conduct can harm customers even if not all firms in the relevant market engage in the coordination, but significant harm normally is likely only if a substantial part of the market is subject to such conduct."

43 *See Horizontal Merger Guidelines*, at 26. "Coordination generally is more profitable, the lower is the market elasticity of demand."

44 *Supra* notes 15 and 26.

45 The avoidance of price wars is an indicator of coordinated interaction. *See Horizontal Merger Guidelines*, at 24. "Coordinated interaction also can involve a similar common understanding that is not explicitly negotiated but would be enforced by the detection and punishment of deviations that would undermine the coordinated interaction."

46 Clearwire, a firm whose majority share is controlled by Sprint, has entered the mobile data, but not cellular, market. However, it has struggled in building a retail base and is shifting focus to the wholesale market. Lightsquared, the mobile satellite spectrum firm, has stated its intention to offer nationwide wholesale LTE services (including voice-over-LTE), but the firm's prospects for timely and sufficient entry are dubious given the serious regulatory and engineering obstacles surrounding interference concerns with its technology.

47 *Supra* note 26. The margins of the carriers at the very top, particularly Verizon, are increasing, while existing firms are seeing eroding margins and subscribers. "Only four of the 12 leading carriers were able to log sequential EBITDA gains last quarter, as smaller carriers struggle to manage costs amid shrinking or flattening subscriber bases and high smartphone handset subsidies increase equipment expenses."

difficult.[48] New entrants would have to amass substantial spectrum assets, navigate local and federal regulations, and incur substantial fixed deployment costs prior to signing up a single customer. In addition, the high valuation of existing leading firms indicates intangible assets that a new entrant would not be able to sufficiently and quickly duplicate.[49]

Even if timely entry were possible, the existing market structure makes it such that this entry would not be sufficient to mitigate the unilateral and coordinated harms of this merger. In the smartphone cellular service market, AT&T and Verizon have used handset exclusivity to differentiate, and this practice, along with the substantial switching costs, creates insurmountable barriers to effective entry.[50]

Further, when considering the core market of nationwide smartphone cellular service, AT&T and Verizon are the *only* carriers with excess capacity in the form of unutilized beachfront spectrum. This means that sufficient output expansion by a rival firm is all but impossible.[51] Regional carriers have very little AWS and 700 MHz spectrum and rely on the national carriers for data roaming (at terms set by the national carriers). The major pre-paid carriers similarly lack prime spectrum for data services and would not be a sufficient check on the market power of the strengthened post-merger duopoly.

THE CLAIMED EFFICIENCIES OF AT&T'S ACQUISITION OF T-MOBILE ARE SPECULATIVE, NON-MERGER SPECIFIC, NON-COGNIZABLE, AND WOULD NOT OUTWEIGH THE ADVERSE COMPETITIVE IMPACT OF THIS TRANSACTION

As discussed above, AT&T's primary justification for this horizontal merger is the achievement of efficiencies through the combination of its and T-Mobile's network infrastructure. AT&T claims that it is in the midst of a "spectrum crunch" that only acquisition of T-Mobile's spectrum and infrastructure assets can solve. But this claim is misleading, and even if

[48] AT&T's market valuation is approximately $190 billion, far in excess of the nearly $100 billion in value of its tangible assets. See *Horizontal Merger Guidelines*, at 28. "Lack of successful and effective entry in the face of non-transitory increases in the margins earned on products in the relevant market tends to suggest that successful entry is slow or difficult."

[49] *See Horizontal Merger Guidelines*, at 28. "Market values of incumbent firms greatly exceeding the replacement costs of their tangible assets may indicate that these firms have valuable intangible assets, which may be difficult or time consuming for an entrant to replicate."

[50] *See Horizontal Merger Guidelines*, at 29. "Even where timely and likely, entry may not be sufficient to deter or counteract the competitive effects of concern. For example, in a differentiated product industry, entry may be insufficient because the products offered by entrants are not close enough substitutes to the products offered by the merged firm to render a price increase by the merged firm unprofitable."

[51] *See Horizontal Merger Guidelines*, at 17. "… a firm's competitive significance may derive principally from its ability and incentive to rapidly expand production in the relevant market in response to a price increase or output reduction by others in that market. As a result, a firm's competitive significance may depend upon its level of readily available capacity to serve the relevant market if that capacity is efficient enough to make such expansion profitable."

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true, cites an efficiency that is non-merger specific,[52] non-cognizable[53] and does not outweigh the competitive harms of this transaction.

First, while there is no doubt that mobile data services are increasingly popular and growing, AT&T has offered no actual evidence that it cannot manage this predictable growth through normal means. Indeed, AT&T has been widely criticized for under-investing in its wireless network at a time when Verizon and other carriers were expending capital at higher relative rates.[54] While T-Mobile, which is in a far worse spectrum position, worked on increasing capacity by deploying more spectrally efficient technology, AT&T focused on mergers and acquisitions. But most specious of all is AT&T's claim of spectrum poverty, when it is not only the best positioned carrier in spectrum, but has not yet deployed any of its AWS or 700 MHz spectrum.[55] Thus, AT&T's efficiency claims are non-merger specific and non-cognizable,[56] as the company could achieve these same gains either through utilization of existing assets or other methods such as licensing deals that would enable it to share capacity with other carriers.

Second, even if these claimed efficiencies were merger-specific and cognizable, they would not outweigh the competitive harm of this transaction. AT&T has offered no evidence to suggest that the *net* benefit of these supposed efficiencies would be passed along to its customers. Indeed, AT&T is selling this deal to Wall Street by highlighting its much higher profit margins and plans to raise T-Mobile's.[57] If the DOJ follows its own precedent and guidelines, it will have no choice but to find that the supposed efficiencies do not offset the harms from this merger.[58]

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52 *See Horizontal Merger Guidelines*, at 30, note 13. "The Agencies will not deem efficiencies to be merger-specific if they could be attained by practical alternatives that mitigate competitive concerns, such as divestiture or licensing."

53 *See Horizontal Merger Guidelines*, at 30. "Cognizable efficiencies are merger-specific efficiencies that have been verified and do not arise from anticompetitive reductions in output or service."

54 During 2006-2009, AT&T's wireless capital expenditures as a percentage of revenues were 12.6 percent, versus Verizon's 14 percent. T-Mobile led the major carriers during this period, spending 15.7 percent of its wireless revenues on network investments.

55 It is noteworthy that AT&T is claiming spectrum poverty, while Verizon's CEO has been quoted as saying, "I don't think we have a spectrum shortage," when Verizon has *less* total spectrum than AT&T (and a nearly equivalent amount of AWS and LTE spectrum). AT&T has a total of 2,122 MHz of 3G and 4G spectrum versus 1,838 MHz for Verizon. *See* Marguerite Reardon, "Is AT&T a wireless spectrum hog?," *CNET News*, April 29, 2011. *See also* "A Conversation with Ivan Seidenberg," Council On Foreign Relations, April 6, 2010.

56 These claimed efficiencies are non-cognizable, because they are non-merger specific and would come at the expense of AT&T reducing efficient output by reducing capital deployment. *See Horizontal Merger Guidelines*, at 30.

57 *See* AT&T fact sheet, "AT&T and T-Mobile USA: The Future of Mobile Broadband."

58 *See Horizontal Merger Guidelines*, at 31. "The greater the potential adverse competitive effect of a merger, the greater must be the cognizable efficiencies, and the more they must be passed through to customers, for the Agencies to conclude that the merger will not have an anticompetitive effect in the relevant market."

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LOCAL MARKET DIVESTITURE WILL NOT REMEDY THE ADVERSE COMPETITIVE IMPACTS THAT THIS TRANSACTION WOULD HAVE ON THE NATIONWIDE PRODUCT MARKET

As the Department conducts its analysis, it will have no choice but to challenge this merger.[59] The merger will significantly increase market concentration in an already highly concentrated market.[60] The market structure is such that it is extremely vulnerable to coordinated conduct, and this merger's elimination of a maverick competitor would only exacerbate that vulnerability.

Though the DOJ has never evaluated a merger of this size between two truly national cellular carriers, it has challenged similar transactions, including numerous acquisitions of smaller regional firms by large national carriers. Many of those transactions were ultimately approved with modest behavioral and structural conditions, most notably the divestiture of assets in certain local geographic markets. But these remedies came in an environment where there were still at least four viable national carriers, and where divestiture to other firms was possible without raising additional antitrust concerns. This merger is not like those past transactions. The loss of a major national carrier and the concentration of nearly 80 percent of the market between two firms with legacy monopoly wireline advantages is just too insurmountable an obstacle. It is hard to conceive how local divestiture would mitigate the market harm that this transaction would cause at the national level. Further, because of the increasing market concentration and loss of viable competitive firms, local market divestiture is unlikely to reduce market concentration to an acceptable level. The markets are concentrated to an extent that local divestiture now is simply an exercise in shuffling the deck chairs on the Titanic.

CONCLUSION

The national post-paid wireless market is already one with coordinated effects, one where the top two carriers use their market power to sustain significant non-transitory price increases. This merger would eliminate a major "maverick" nationwide competitor, exacerbating these pre-existing coordination effects, and would also result in substantial unilateral harms. The transaction would further reduce any possibility of competitive threats from the remaining regional carriers that have single-digit marketshares, and that have been unable to exert any meaningful competitive pressure on the nationwide carriers.

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[59] *See Horizontal Merger Guidelines*, at 25. "The Agencies are likely to challenge a merger if the following three conditions are all met: (1) the merger would significantly increase concentration and lead to a moderately or highly concentrated market; (2) that market shows signs of vulnerability to coordinated conduct (see Section 7.2); and (3) the Agencies have a credible basis on which to conclude that the merger may enhance that vulnerability. An acquisition eliminating a maverick firm (see Section 2.1.5) in a market vulnerable to coordinated conduct is likely to cause adverse coordinated effects."

[60] The exact HHI values will depend on how the product and geographic market is defined, whether subscribers or revenues are considered, and the available data. If the market is restricted to carriers that have a national footprint (through self-provisioning and/or roaming, including pre- and post-paid carriers), the HHI would increase from approximately 2,600 to 3,300. If it is restricted to post-paid carriers with national footprints, then the HHI would increase from 2,900 to 3,600. *See* SNL Kagan*, Wireless Industry Benchmarks*.

In short, putting Humpty Dumpty back together is a bad idea. If antitrust law has any meaning left, the Department of Justice should follow past precedent and its own guidelines, and swiftly reject this unthinkable proposal.

Sincerely,

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Cc: Sen. Schumer
Sen. Klobuchar
Sen. Franken
Sen. Blumenthal
Sen. Grassley
Sen. Cornyn