

United States Senate

COMMITTEE ON THE JUDICIARY

WASHINGTON, DC 20510-6275

July 20, 2011

The Honorable Eric Holder
Attorney General
United States Department of Justice
950 Pennsylvania Avenue, N.W.
Washington, D.C. 20530

The Honorable Julius Genachowski
Chairman
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Dear Attorney General Holder and Chairman Genachowski:

I write to you concerning the proposed acquisition by AT&T of T-Mobile USA, now under review at the Justice Department and the Federal Communications Commission. The Senate Subcommittee on Antitrust, Competition Policy and Consumer Rights recently held a hearing to examine the competitive issues surrounding this transaction, and we have now completed our examination of this deal. I have concluded that this acquisition, if permitted to proceed, would likely cause substantial harm to competition and consumers, would be contrary to antitrust law and not in the public interest, and therefore should be blocked by your agencies.

This acquisition would have enormous consequences for consumers. Cell phones are now ubiquitous in American life, with over 274 million subscribers, and have become almost a utility necessary for daily life. Therefore, in this industry, perhaps more than any other, full and vibrant competition is essential so that all consumers realize the benefits of this technology at the best prices and with the most choices. Much more than for voice calling, consumers now rely on their cell phones to access the Internet, exchange e-mail, watch TV and movies, and manage their busy lives. As you know, AT&T and T-Mobile are direct head-to-head competitors¹ and two of the only four wireless phone providers with national networks in the United States.² If this acquisition were to proceed, it would amount to a four-to-three merger among national cell phone providers in an already highly concentrated market. Today, the top four competitors – AT&T, Verizon, Sprint and T-Mobile – control over 90% of the cell phone market as measured by revenue. Should this proposed acquisition proceed, AT&T and Verizon will control nearly 80% of this market.

¹ The CEOs of T-Mobile and AT&T both acknowledged at our hearing that they were direct competitors of each other. Phillip Humm, CEO of T-Mobile, stated that “we are competing in the same markets.” Randall Stephenson of AT&T, when asked if the two companies were “major competitors,” stated “yes, sir, we are.”

² Each of these four nationwide service providers have mobile networks that cover more than 87.5 % of the U.S. population. FCC “Annual Report and Analysis of Competitive Market Conditions With Respect to Mobile Wireless, Including Commercial Mobile Service” (released June 24, 2011) (hereinafter “2011 Wireless Competition Report”) ¶ 27.

T-Mobile has been a price leader in the cell phone market, offering prices and rate plans significantly less expensive than the other three national cell phone providers. According to a recent price analysis survey of voice and data plans conducted by Consumer Reports, “T-Mobile wireless plans typically cost \$15 to \$50 per month less than comparable plans from AT&T.”³ Removal of such a maverick price competitor from such a highly concentrated market – a competitor that disciplines price increases from all three other national cell phone competitors, not only AT&T – raises a substantial likelihood that prices will rise following this merger. Such a result is unacceptable under antitrust law and as a matter of communications policy.

Under antitrust law, a merger or acquisition from four to three main competitors in an already significantly concentrated market is highly suspect under Section 7 of the Clayton Act, the statute that forbids mergers and acquisitions which “may tend to substantially lessen competition.” Indeed, just last year in comments to the FCC on the proposed national broadband plan, the Justice Department stated that “based on its extensive experience in evaluating horizontal mergers, the Department starts from the presumption that in highly concentrated markets consumers can be significantly harmed when the number of strong competitors declines from four to three...”⁴ There can be no doubt that the wireless phone market – with four national competitors controlling over 90% of the market – is a highly concentrated market.⁵

An acquisition which would decrease the number of national competitors from four to three in an already highly concentrated market, and one that eliminates the low price competitor from this market, is in my view highly dangerous to competition and consumers. It will likely tend to substantially lessen competition, lead to consumers paying high prices with fewer choices, as well as lessen the innovation that has been the keystone of this industry in the last decade. It is my judgment that this acquisition in such a vital consumer service should be blocked by your agencies as contrary to antitrust law and not in the public interest under communications law.

AT&T and T-Mobile defend this acquisition on several grounds, all which are without merit in my view. First, they contend that this acquisition should not be evaluated on a national basis, but instead on a local market-by-market basis. They contend that there are several other mobile phone providers in many local markets beyond the four national carriers, so that this is not a four to three merger in the majority of local markets.⁶

³ Blyskal, Jeff, *CR analysis: T-Mobile is cheaper than AT&T*, Consumer Reports Online (April 8, 2011) found at <http://news.consumerreports.org/electronics/2011/04/cr-analysis-t-mobile-is-cheaper-than-att.html>

⁴ *Ex Parte* Submission of the U.S. Department of Justice, “In the Matter of Economic Issues in Broadband Competition: A National Broadband Plan for Our Future,” FCC GN Docket No. 09-51 (Jan. 4, 2010), at page 15. The leading antitrust treatise, summarizing the existing case law and government precedents, notes that significant mergers in highly concentrated markets “bear a strong presumption of illegality.” It adds that mergers “reducing the number of ‘significant’ firms from four to three, or five to four, typically fall into this classification.” Areeda and Hovenkamp, Antitrust Law, Vol. IV, ¶ 925c at p. 131 (3d Ed. 2009).

⁵ Under the joint Justice Department/Federal Trade Commission merger guidelines, a market is considered “highly concentrated” when the Hirschman-Hirschfeld Index (HHI, the standard measure of market concentration) is over 2500. U.S. Department of Justice/Federal Trade Commission Horizontal Merger Guidelines (issued Aug. 19, 2010)(hereinafter “DOJ/FTC Merger Guidelines”) at p.131. According to the FCC, the weighted average HHI index for the cell phone industry was 2848. 2011 Wireless Competition Report ¶ 52.

⁶ However, in prior wireless mergers, AT&T and its predecessor companies strongly argued that the wireless market was properly considered to be a national market. In its FCC filings, AT&T Wireless argued that its 2004 merger with Cingular “should be analyzed as national,” and AT&T argued that, in its 2008 merger with Centennial that “the evidence shows that the predominate forces driving competition among wireless carriers operate at the national level.”

However, I believe the market is properly evaluated on a national basis, and that the local competitors are not competitively significant players in this national market. Unlike landline phones, which are fixed in one location, consumers purchase wireless phone service because the phones are mobile and travel with the consumer. Therefore wireless phone companies must provide service throughout the United States, not merely in the localities in which they are based.

No other cell phone companies beyond the four national carriers have their own national networks on which to provide nationwide coverage. Therefore, when a local or regional carrier – such as Leap/Cricket, Metro PCS, US Cellular, or Cellular South – seeks to provide service to customers travelling outside that company’s local or regional service area, it must “roam” on the network of another carrier, typically one of the four national carriers, and pay substantial roaming fees to these carriers.

In addition, the local and regional cell phone companies have stated that they often have difficulties in gaining roaming agreements with the national carriers, despite these carriers’ legal obligations to do so. Until recently, there was not even a legal right to roam for non-voice applications such as internet connections (so-called “data roaming”) so vital for the operation of smartphones. Although the FCC in April enacted new rules requiring the national carriers to offer limited data roaming at commercially reasonable rates, these rules have been challenged by Verizon in court as being outside the FCC’s authority. Even if the FCC’s authority is upheld, it is unclear what will constitute “commercially reasonable” rates.⁷ The bottom line is that the smaller local and regional cell phone companies will be paying their national competitors large sums of money in order to provide their customers nationwide cell phone service. Placing such a key input in the hands of their national competitors unquestionably will hamstring these smaller carriers in their efforts to compete with the national cell phone companies.

A similar issue arises with respect the local wireless carriers’ need to connect to the incumbent phone companies’ (principally AT&T and Verizon) landline networks in order to complete phone calls. In order to do so, they must pay large amounts in what is known as “special access” charges. In fact, one industry expert estimated that AT&T and Verizon collect profits of at least \$ 10 billion in special access charges annually.⁸ It has been estimated that AT&T and Verizon collectively collect 81% of all special access revenues within their service territories.⁹ Indeed, at

See Cingular and AT&T Wireless Public Interest Statement in the Cingular/AT&T Wireless Merger (March 2004) at p. 30; AT&T Public Interest Filing, Merger of AT&T, Inc. and Centennial Communications, November 21, 2008 at p. 28.

⁷ It is also highly questionable under the FCC Order whether data roaming rights will extend to the next generation of smartphones. “In the Matter of the Reexamination of Roaming Obligations of Commercial Mobile Radio Service Providers and Other Providers of Mobile Data Services (FCC April 7, 2011) ¶ 47 (“it is also commercially reasonable for a provider to refuse to enter into a data roaming arrangement for a particular data service where it is not technically feasible to provide roaming for such service and where any changes to its network that are necessary to accommodate such data roaming are economically unreasonable”).

⁸ Declaration of Lee J. Selwin on behalf of The Ad Hoc Telecommunications Users Committee, “In the Matter of Application of AT&T Inc. and Deutsche Telekom AG For Consent to Assign or Transfer Control of Licenses and Authorization,” FCC WT Docket No. 11-65 (hereinafter “FCC AT&T/T-Mobile Merger Proceeding”) ¶ 33 (filed May 31, 2011).

⁹ Written Testimony of Paul Schieber, Vice President of Access and Roaming, Sprint Nextel, Hearing of the House Subcommittee on Communications, Technology and the Internet On An Examination of Competition in the Wireless Industry, May 7, 2009, at p. 5 (citing 2007 FCC ARMIS Report 43-01, Table 1). Even T-Mobile complained last year regarding special access charges, stating “in areas where ILECs continue to enjoy a monopoly, backhaul costs remain unreasonably high.” May 6, 2010 Letter from Kathleen O’Brien Ham, Vice President, T-Mobile to Marlene H. Dortch,

our hearing, Dan Hesse of Sprint testified that “30 percent of the cost of putting in a new cell site goes back to a local landline carrier in the form of payments for special access, and those rates are very, very high.” The fact that the local and regional wireless phone companies effectively subsidize their national competitors to access their landline networks is another factor that strongly restrains these local and regional competitors from serving as full-fledged competitors.

Additionally, the local and regional phone companies are further handicapped from competing fully with the national competitors because they cannot offer consumers many of the most in-demand smartphones, including for example, the iPhone. Cell phones have undergone substantial technological advancements in recent years. Consumers now rely on their wireless devices for far more than making phone calls, but use them instead to search the Internet, to exchange emails, and to run numerous applications. According to the 2011 FCC Wireless Competition Report, in April 2009, 69% of American adults had used some type of non-voice, mobile data service. Wireless Competition Report, ¶164. Further, during the third quarter of 2010, an estimated 41% of recent handset purchases were of advanced smartphones, and this number is growing. *Id.* ¶ 2, p. 20. Offering the most up to date smartphones is crucially important to being a competitive cell phone carrier, and these smaller carriers cannot get access to many of these devices because only the national carriers have the subscriber base and the leverage to get multi-year exclusive contracts for these smartphones. The fact that many of the most in-demand smartphones are not available to carriers other than the four national cell companies is, therefore, another reason that the local and regional companies cannot be considered to be full-fledged competitors.

Another important indication that competition occurs on the national, and not local, level is the fact that the major carriers all have national pricing plans. T-Mobile forthrightly admitted this in its answers to my written follow-up questions after the hearing, stating that “T-Mobile’s pricing plans have historically been set on a nationwide basis.”¹⁰ Likewise AT&T’s pricing plans for voice and data services are set on a national basis. This is strong evidence that competition for cell phone services is national. Common sense dictates that if local competition was relevant, one would see different pricing plans offered in different localities. The absence of such local price competition belies the parties’ contention that the cell phone market is a local, not national, market.¹¹

In summary, on the issue of national vs. local market, I believe this acquisition is properly analyzed on a national basis as a merger of two of the four national cell phone companies. The local competitors that AT&T cites are not full-fledged competitors to the four national carriers, as they are hamstrung by their need to pay their national competitors large sums in roaming and special access charges (and their ability to obtain data roaming for new technologies is seriously in question) and their inability to access many of the most in-demand smartphones. Moreover, the

Secretary, FCC (Re: Notice of Ex Parte Communication: *Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket No. 05-25).

¹⁰ Phillip Humm Answer to Question # 3, “Follow-Up Questions of Sen. Herb Kohl to Hearing on ‘The AT&T/T-Mobile Merger: Is Humpty Dumpty Being Put Back Together Again?’ ”

¹¹ AT&T and Verizon contend that they offer local promotions for such items as new phone pricing. T-Mobile asserts that they have created “locally-focused operations teams in 23 discrete local areas.” Phillip Humm Answer to Question 3, “Follow-Up Questions of Sen. Herb Kohl to Hearing on ‘The AT&T/T-Mobile Merger: Is Humpty Dumpty Being Put Back Together Again?’” Whatever the companies’ occasional local promotions with respect to telephone handsets or their creation of “locally-focused operations teams” in their corporate bureaucracy, the fact remains that the pricing of the fundamental service at issue here – the price of voice minutes and internet data connections – is set on a national, not local, level.

fact that prices for the basic components of cell phone service – voice and data connections – are set on a uniform national basis is strong support for analyzing this acquisition on a national basis.

AT&T and T-Mobile also justify this acquisition by arguing that it will improve the service offered to current customers of both AT&T and T-Mobile. Specifically they claim the deal will (i) solve the alleged problem of T-Mobile not having a “clear path” to the newest wireless technology, so-called 4G LTE, (ii) enable AT&T to serve more customers in rural areas, and (iii) enable AT&T to better serve customers in urban areas, where it contends AT&T is running out of spectrum. I find none of these arguments convincing to justify such a clearly anti-competitive acquisition.

We must be mindful of the fact that in evaluating these asserted merger efficiencies, under the Justice Department/FTC Horizontal Merger Guidelines, antitrust enforcers “credit only those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects... Efficiency claims will not be considered if they are vague, speculative, or otherwise cannot be verified by reasonable means.”¹² In my view, AT&T and T-Mobile have not made the requisite showing and many of their asserted efficiencies are highly speculative at best.

First, the argument that T-Mobile does not have a sufficient plan to serve consumers with 4G LTE services is contrary to T-Mobile’s own business plans immediately prior to the announcement of the acquisition. On January 20, 2011, at an investor conference, T-Mobile’s Chief Technology Officer Neville Ray stated, “I think there has been a belief that there is spectrum shortage at T-Mobile. That is not the case in the near term or the medium term. If you look at your volume of spectrum that T-Mobile has today, our ability to grow in the wireless data space is much stronger than our competition. So we are in a good spot, and do not have a shortage of spectrum.” It appears that T-Mobile indeed has a well developed plan to serve consumers with 4G services, and extensive spectrum holdings to do so, without the need to enter into this acquisition.¹³

Second, AT&T’s claim that it needs this acquisition to serve rural areas with advanced wireless services is not a sufficient reason to support this merger. While we of course recognize the vital importance of wide broadband deployment to underserved rural communities, the record simply does not support the notion that this acquisition is necessary to achieve this goal. Specifically, AT&T claims it will be able to serve 97% of the nation’s population with the next generation 4G LTE’s services within six years after this acquisition¹⁴, up from the 80% it now plans to serve in the future. AT&T’s assertion that the deal will help it expand by 17% a new generation of cell phone service not yet deployed *six years from now* is plainly too speculative and uncertain to justify this merger under the antitrust laws. Further, it appears that much of the spectrum to be acquired by AT&T does not even serve the rural areas that AT&T claims will

¹² DOJ/FTC Horizontal Merger Guidelines (Aug. 19, 2010) at p. 30.

¹³ Moreover, it is clear that T-Mobile is a highly profitable company. The FCC reports that T-Mobile had an EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization, a common industry measure of profits) margin of 29.1% for the fourth quarter of 2009. FCC Wireless Competition Report at p. 137. T-Mobile reported an OIBDA (Operating Income Before Depreciation and Amortization) margin of 29% for all of 2010. See <http://www.tmobile.com/Cms/Files/Published/0000BDF20016F5DD010312E2BDE4AE9B/5657114502E70FF3012FD6A0635D5CAB/file/TMUS%20Q1%202011%20Press%20Release-Final.pdf>

¹⁴ Randall Stephenson Answer to Question 1(d), Questions for the Record of Sen. Al Franken, Hearing on “The AT&T/T-Mobile Merger: Is Humpty-Dumpty Being Put Back Together Again?”

benefit from the transaction.¹⁵ Thus the deployment of rural wireless cannot be considered a “merger specific” efficiency under the Merger Guidelines. The FCC national broadband plan shows that there are many ways to achieve the laudable goal of widespread broadband deployment to rural areas without the market consolidation and risks to competition inherent in AT&T’s acquisition of T-Mobile.

AT&T’s claims regarding the enhancement of service in urban areas as a result of this acquisition are likewise unpersuasive. There was considerable testimony at our hearing that service enhancements could be achieved by investing in new equipment and cell sites and other technological upgrades.¹⁶ It seems that AT&T could achieve the goal of improving service by spending a portion of the \$39 billion it plans to spend to acquire T-Mobile, and without seriously injuring competition in the process.

Another serious concern posed by this proposed acquisition is the future of the third national competitor – Sprint – should this deal take place. There is considerable doubt as to whether Sprint could survive as an independent competitor should AT&T and Verizon capture a combined 80% market share after this acquisition. The CEO of Sprint, Dan Hesse, testified at our hearing that this acquisition would make “the competitive environment... much more difficult for Sprint” and that Sprint would be “much more of a takeover target.” When asked directly if, after this acquisition, there was a danger in the market going “from three to two,” Hesse replied “[t]hat is correct, Senator.” Hesse pointed out Sprint would be at a significant disadvantage in getting access to advanced smartphones, as AT&T and Verizon would have “tremendous scale advantages” over Sprint with the device manufacturers. Further, he argued, Sprint would be subsidizing its competition substantially with special access fees paid to AT&T and Verizon.¹⁷

While we recognize that antitrust policy is not designed to protect any specific competitor, but competition generally, we cannot turn a blind eye to the dangerous possibility that this acquisition could ultimately result in a duopoly in the national cell phone market. In my view, a duopoly in this crucial marketplace would be a wholly unacceptable outcome.

Having concluded that this proposed acquisition would seriously harm competition, I find no feasible or practical merger conditions that could significantly remedy this harm. Further, placing far reaching conditions on this deal would involve extensive regulatory supervision and interference with the complex, on-going business operations of AT&T. A structural solution to the competition problems posed by the proposed acquisition – that is, simply prohibiting the proposed acquisition –

¹⁵ According to the Consumers Union and other public interest groups’ FCC filing, T-Mobile’s spectrum holdings “would appear to be largely duplicative of AT&T’s holdings when it comes to geographic coverage.” Joint Petition to Deny of Center for Media Justice, Consumers Union, et. al., FCC AT&T/T-Mobile Merger Proceeding at p. 33 (filed May 31, 2011). And according to Sprint Nextel, “AT&T’s spectrum footprint already covers 97 percent of the U.S. population; the addition of T-Mobile’s spectrum would produce very little further coverage.” Reply Comments of Sprint Nextel, FCC AT&T/T-Mobile Merger Proceeding at p. 69 (filed June 20, 2011).

¹⁶ For example, Gigi Sohn of Public Knowledge asserted that “Verizon has fewer spectrum holdings compared to AT&T and has more customers, but it has clearly stated that it does not envision having capacity issues until 2015 at the earliest. . . . AT&T still has significant amounts of unused spectrum capacity available and has not taken full advantage of technologies that would make more efficient use of its existing spectrum assets and capacity.” Gigi Sohn Answer to Question 7, “Follow-Up Questions of Sen. Herb Kohl to Hearing on ‘The AT&T/T-Mobile Merger: Is Humpty Dumpty Being Put Back Together Again?’ ”

¹⁷ See also, New York Times Dealbook, “T-Mobile Deal Leaves Sprint’s Future Unclear,” (March 20, 2011) <http://dealbook.nytimes.com/2011/03/20/t-mobile-deal-leaves-sprints-future-unclear/?pagemode=print>

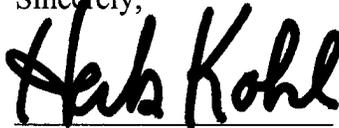
is far preferable. In general, taking necessary action to preserve competition is a much better course of action than extensive governmental regulation and entanglement with complicated and quickly changing technology markets.

In sum, the proposed acquisition of T-Mobile by AT&T would, in my view, create a substantially lessening of competition, and therefore is contrary to antitrust law and should be enjoined. It will eliminate the head-to-head competition between AT&T and T-Mobile, reduce an already concentrated national cell phone market from four to three competitors, and result in two of these competitors – AT&T and Verizon – controlling about 80% of the cell phone market. It will pose a substantial danger to consumers of higher cell phone bills and fewer choices for service at exactly the wrong time – when consumers are relying more and more every day on wireless phone services to make and receive voice calls, exchange emails and text messages, search the Internet, and use many other applications.

Approval of this acquisition would also reverse the historic triumph of competition policy of three decades ago – the breaking up of the AT&T phone monopoly into numerous competitors, unleashing an explosion of innovation that led to such technologies as cell phones and the Internet. To replace the AT&T phone monopoly of the last century with a near-duopoly of AT&T and Verizon today would be harmful to consumers, contrary to antitrust law and not in the public interest under communications law, and I therefore urge your agencies to take all necessary actions to deny approval of this merger.

Thank you for your attention to this matter.

Sincerely,

A handwritten signature in black ink that reads "Herb Kohl". The signature is written in a cursive, slightly slanted style.

HERB KOHL

Chairman, Subcommittee on
Antitrust, Competition Policy, and
Consumer Rights