The Law and Economics of the FCC's Transaction Review Process

Geoffrey Manne, Will Rinehart, Ben Sperry, Matt Starr & Berin Szoka[1]

I. Introduction ... 2

II. The FCC's Current Transaction Review Process ... 3

A. The FCC as Competition Authority ... 3

B. The FCC's Spectrum Screen ... 5

1. History of the Spectrum Screen ... 5
2. Structure of the Two-Part Spectrum Screen ... 7
3. Use of Conditions in Spectrum Transactions ... 9

C. The FCC Exceeds its Statutory Limits in the Transaction Review Process ... 10

1. The FCC's Legal Basis for Review ... 10
2. The FCC Routinely Transgresses Its Authority in Transaction Reviews ... 12
3. Improper consideration of hypothetical, alternate transactions ... 12
   a) The FCC Violates Section 310(d) by Considering Imaginary Transactions ... 14
4. Consideration of Transactions Outside the Scope of the FCC's Authority ... 16
5. The FCC's Extralegal Use of Transaction Conditions ... 20

III. The FCC's Outdated Economic Model for Transaction Reviews ... 21

A. The FCC Improperly Relies upon HHI and Spectrum Concentration Metrics to Create a per se Presumption that Certain Transactions are Illegal ... 21

1. The FCC's Spectrum Screen in Practice ... 22
2. The Faulty Economics of the Spectrum Screen ... 23
3. After the Spectrum Screen: "Further Competitive Analysis" ... 26

B. Big is not Always Bad: The Consumer Welfare Standard ... 29

1. The FCC versus the Horizontal Merger Guidelines ... 31
2. Burden of Proof ... 34

IV. Lessons from the Failed AT&T / T-Mobile Merger ... 34

A. The FCC's Case Against the AT&T / T-Mobile Merger ... 34

B. Analysis of the FCC's Analysis ... 37

1. Market Share and Market Definition ... 37
2. Competitive Effects ... 40
   a) Coordinated Effects ... 40
      (1) T-Mobile as Maverick ... 42

[1] The authors are, respectively, Manne: Lecturer in Law, Lewis & Clark Law School and Executive Director, International Center for Law & Economics; Rinehart: Research Fellow, TechFreedom; Sperry: Associate Director, International Center for Law & Economics; Starr: Legal Fellow, International Center for Law & Economics and Legal Fellow, TechFreedom; Szoka: President, TechFreedom.

Electronic copy available at: http://ssrn.com/abstract=2242681

b) Unilateral Effects 44
3. Entry 48
4. Summing Up 49

V. Concluding Thoughts — Suggestions for Reform 50

A. The FCC Should Employ a Rule of Reason Analysis and Only Consider Consumer Welfare Effects of License Transfers in the Screen 50

B. The Burden of Proof Should Fall on the Reviewing Agency, not the Parties to a Proposed Transaction 51

C. The FCC Should not Impose Conditions Unrelated to Demonstrated Consumer Harms 52

D. Congress Should Abolish Duplicative Merger Reviews 52

E. A Revamped Case-by-Case Analysis Is Necessary 53

I. INTRODUCTION

The Federal Communication Commission (FCC) is again in the news, with the pending confirmation and appointment of Thomas Wheeler as FCC Chairman, and a debate over statements about the FCC's use of merger conditions to regulate informally and outside the notice-and-comment rulemaking process.[2] Regulatory advocates have succeeded in pressuring the FCC to impose conditions to address concerns as diverse as net neutrality, vertical integration, and a range of other non-economic conditions the FCC decided were in the "public interest," including race-based set-asides of channel capacity.[3] The FCC's critics have decried such "voluntary" conditions as an abuse of the FCC's transaction review process,[4] leading the House of Representatives to pass an FCC process reform that would cabin that authority.[5] This debate has particularly focused on the FCC's authority over transfers of spectrum, both between private parties and through auctions.

This article assesses the FCC's current policies and rules regarding transaction reviews, concluding that the Commission's current approach harms consumer welfare. In particular, the FCC's spectrum screen as currently structured, the agency's standard of review for spectrum transfers, its use of conditions, as well as the scope of its transaction reviews exceed legal limits, impede efficient markets for spectrum, and deter welfare-increasing transactions and investment.

For it to facilitate, rather than impede, the deployment of spectrum and its accompanying benefits, the FCC can't improperly block consumer-welfare enhancing transactions that re-allocate spectrum to its highest valued uses. We argue that the Commission's current spectrum transfer review process is not up to the task, and that the FCC must adopt a more economically-rigorous approach to license transfer

---

[2] John Eggerton, *Wheeler: Merger Reviews Should Be Fact-Specific*, BROADCASTING & CABLE (Jun. 18, 2013), http://www.broadcastingcable.com/article/494107-Wheeler_Merger_Reviews_Should_Be_Fact_Specific.php.

[3] [Cite]

[4] [Cite]

[5] HR 3309 http://thomas.loc.gov/cgi-bin/query/z?c112:H.R.3309.RFS:/

Electronic copy available at: http://ssrn.com/abstract=2242681

reviews—one that does not trade away effectiveness for the sake of mere administrability nor dynamic, forward-looking efficiency for the sake of the Commission's flawed vision of an optimal, static market structure. Rather, the FCC should follow the lead of its antitrust agency counterparts and employ a "rule of reason" analysis in its review of spectrum transfers. Moreover, the FCC should defer to the comparative advantage of its antitrust agency counterparts in the review of transactions that come before both the FCC and the DOJ or FTC, and forebear from such analysis entirely except to inform and advise the DOJ's or FTC's comprehensive antitrust review.

Part II explains the FCC's current policies and decisions regarding transaction reviews in general and assesses the propriety of those reviews under the Commission's authorizing legislation, regulations and case law. We conclude that the FCC's practices exceed their permissible limits.

Part III addresses the economics of the FCC's policies and decisions, explaining and assessing the animating economic logic behind the FCC's analysis. We demonstrate that the FCC's current spectrum screen and transaction review standards rest on the premise that the concentration of spectrum necessarily leads to anticompetitive behavior. We then explain the flaws in this premise, comparing it with modern merger review under the FTC/DOJ Horizontal Merger Guidelines and finding it wanting.

Part IV undertakes a detailed critique of the FCC Staff Analysis of the AT&T / T-Mobile merger. Although this analysis represents the most thorough and methodologically sound review undertaken by the FCC to date, it ultimately demonstrates the same fatal flaws that plague the FCC's transaction reviews more generally.

Part V concludes with a discussion of the policy implications of our analysis and suggestions for reform.

II. THE FCC'S CURRENT TRANSACTION REVIEW PROCESS

The FCC's abuse of transaction conditions is just part of a larger problem with the FCC's transaction review processes. Part I.A summarizes the history of the FCC's transaction review authority, including a short discussion of its standard of review in telecommunication mergers and transfers of wireline and spectrum licenses. Part I.B explains the FCC's spectrum screen, including the historical development of the current process for reviewing transfers of spectrum licenses, the analytical structure of the spectrum screen, and how the FCC imposes – or extracts – approval conditions. Part I.C examines the legal basis for the FCC's practices, concluding that the FCC is acting outside of legal limits during the screen itself as well as when the FCC demands "voluntary" conditions for practices outside of its authority to review.

A. The FCC as Competition Authority

The FCC reviews telecommunications mergers to ensure that the transfer FCC licenses serve the public interest.[6] On top of the bare text of the statute, the Commission has developed a framework for assessing what is in the "public interest" that includes a competition analysis component, but the FCC also reviews

[6]. 47 U.S.C. § 310(d) ("No … license … shall be transferred, assigned, or disposed … by transfer of control of any corporation holding such permit or license, to any person except upon application to the Commission and upon finding by the Commission that the public interest, convenience, and necessity will be served thereby").

Electronic copy available at: http://ssrn.com/abstract=2242681

mergers and transactions to promote diversity, localism, and other interests the agency deems important. Thus, the FCC's analysis need not strictly follow the antitrust analysis of the Department of Justice (DOJ). As the D.C. Circuit once stated, the FCC's job is to "make findings related to the pertinent antitrust policies, draw conclusions from the findings, and weigh these conclusions along with other important public interest considerations."[7] In addition, the FCC's standards of review and burdens of proof are not the same as the DOJ's.

The FCC and the DOJ both start their antitrust analyses with market definition, determine if there is market power, and assess barriers to entry and efficiencies that may result from the transaction. The biggest differences between the approach of the antitrust agency and that of the FCC lies in their burdens of proof and scope of review. The DOJ reviews mergers and acquisitions pursuant to Section 7 of the Clayton Act. If the DOJ files a complaint to block a transaction, the DOJ must demonstrate to a court that the merger may substantially lessen competition or tend to create a monopoly.[8] But when a transaction or merger arises before the FCC, the applicants bear the burden of showing that the transaction will serve the public interest. The scope of DOJ's review is limited solely to the competitive effects of the acquisition, without any consideration of the FCC's public interest standards of diversity, localism, *etc.*[9] Finally, the FCC has claimed that the public interest standard allows the competitive analysis to be somewhat broader — for instance, the FCC may require applicants to show a transaction will enhance, rather than merely preserve, existing competition — and thus the FCC more extensively reviews claims of potential and future competition for the transaction's impact on the relevant market.[10]

The FCC derives its authority to review telecom mergers and transfers of control from Section 310(d) of the Federal Communications Act:

> No construction permit or station license, or any rights thereunder, shall be transferred, assigned, or disposed of in any manner, voluntarily or involuntarily, directly or indirectly, or by transfer of control of any corporation holding such permit or license, to any person except upon application to the Commission and upon finding by the Commission that the public interest, convenience, and necessity will be served thereby. Any such application shall be disposed of as if the proposed transferee or assignee were making application under section 308 of this title for the permit or license in question; but in acting thereon the Commission may not consider whether the public interest, convenience, and necessity

[7] United States v. FCC, 652 F.2d 72, 82 (D.C. Cir. 1980) (quoting *Northern Natural Gas Co. v. FPC*, 399 F.2d 953, 961 (D.C.Cir.1968)).

[8] 15 U.S.C. § 18.

[9] *See, e.g.*, *AT&T-Centennial Order*, 24 FCC Rcd at 13928 ¶ 29; *Verizon Wireless-ALLTEL Order*, 23 FCC Rcd at 17462 ¶ 28; *Sprint Nextel-Clearwire Order*, 23 FCC Rcd at 17581 ¶ 21.

[10] *See, e.g.*, *AT&T-Qualcomm Order*, 26 FCC Rcd at 17599-17600 ¶ 25; *AT&T-Centennial Order*, 24 FCC Rcd at 13928 ¶ 29; *Verizon Wireless-ALLTEL Order*, 23 FCC Rcd at 17462 ¶ 28.

> might be served by the transfer, assignment, or disposal of the permit or license to a person other than the proposed transferee or assignee.[11]

All of the most significant transaction reviews undertaken by the Commission in recent years have involved transfers of spectrum licenses, triggering review under this section of the Act. As a result, transaction reviews at the FCC are inextricably tied up with the thorny and contentious issue of spectrum policy.

B. The FCC's Spectrum Screen

The FCC manages spectrum in several important ways: It organizes and runs auctions of new spectrum, allocates spectrum to particular uses, licenses spectrum to particular users, and assesses transactions involving spectrum for their competitive effect. In reviewing the allowable allocation of spectrum through private transactions, the Commission employs a "spectrum screen" to limit the amount of spectrum that any party may obtain.

The FCC's spectrum screen has undergone several iterations. Part I.B.1 briefly outlines this history and emphasizes that the FCC has (wisely) moved from spectrum caps to a spectrum screen in order to maximize consumer welfare. Part I.B.2 discusses the structure of the current spectrum screen and the FCC's standard of review. Part I.B.3 focuses on the FCC's use of conditions and, in particular, how these conditions relate to the FCC's larger spectrum review process.

1. History of the Spectrum Screen[12]

In its September 28, 2012 Notice of Proposed Rulemaking (NPRM),[13] the FCC opened up its spectrum review process for comment. Among the criticisms noted by the FCC was that the spectrum screen left businesses without certainty as to whether their acquisition would be upheld. Some critics of the screen requested a return to the spectrum cap in order to alleviate this uncertainty.[14] As we explain below, the FCC abandoned spectrum caps and other hard limits on spectrum holdings because of the inefficiencies such arbitrary rules create. While the FCC's current use of the spectrum screen leaves much to be desired, the move away from caps was a positive development.

The general movement, until the recent NPRM, has been away from caps and cross-ownership restrictions aimed at restricting the amount of spectrum that can be owned, in favor of case-by-case evaluation. The results of this shift can be seen in the rules that the FCC has developed for cellular services, broadband personal communication services (PCS), and commercial mobile radio services (CMRS).

---

[11] 47 U.S.C. § 310(d) (2006). It also has the authority to review transfers of common carriage wires under 47 U.S.C. § 214(a). The FCC also has the authority to review transactions under the Clayton Act, but because it has broader authority under the FCA, it generally chooses to review transactions under that statute.

[12] The history in this section follows closely the FCC's rendition in the NPRM on Mobile Spectrum Holdings.

[13] In the Matter of Policies Regarding Mobile Spectrum Holdings, WT Docket No. 12-269, Before the Federal Communications Commission.

[14] *Id.* at

The FCC's earliest attempts to regulate through the transaction review process involved establishing rules for the licensing of cellular service. The FCC's first rule was passed in 1981, awarding only two cellular services licenses per market in its attempt to limit the ability of a single entity to dominate the national cellular market: an allocation of 20 megahertz for incumbent wireline carriers and an allocation of 20 megahertz for other applicants.[15] In 1991, the FCC adopted the cellular cross-interest rule, which prohibited a party with a controlling interest in one of the cellular licensees from having more than a 5% direct or indirect ownership interest in the other licensee in the same cellular geographic service area.[16] The goal of the rule was "to guarantee the competitive nature of the cellular industry and to foster the development of competing systems."[17]

Eventually, though, the FCC recognized that the cross-interest rule had outlived its usefulness, given the development of effective competition in the cellular marketplace. First, in 2001, the FCC eliminated the cellular cross-interest rule in urban markets after finding, in its Second Biennial Review Order, substantial effective competition.[18] In 2004, the FCC then extended its case-by-case review to all markets, finding that the cellular cross-interest rule was likely impeding the development of new services in rural and underserved areas.[19]

Similarly, the FCC moved away from service-specific caps and limitations on cross-ownership in its PCS service rules.[20] In the initial PCS service rules, the FCC limited broadband PCS licensees to 40 megahertz of total spectrum allocated to broadband PCS,[21] and limited cellular licensees to 10 megahertz of broadband PCS spectrum in their cellular service areas.[22] In 1994 the FCC created a 45 megahertz CMRS

---

[15] Inquiry Into the Use of the Bands 825-845 MHz and 870-890 MHz for Cellular Communications Systems; and Amendment of Parts 2 and 22 of the Commission's Rules Relative to Cellular Communications Systems, CC Docket No. 79-318, Report and Order, 86 FCC 2d 469, 488-92 ¶¶ 38-43 (1981) (*Cellular Report and Order*).

[16] Amendment of Part 22 of the Commission's Rules to Provide for Filing and Processing of Applications for Unserved Areas in the Cellular Service and to Modify Other Cellular Rules, CC Docket No. 90-6, First Report and Order and Memorandum Opinion and Order on Reconsideration, 6 FCC Rcd 6185, 6628 ¶¶ 104-05 (1991) (*Cellular First Report and Order*).

[17] *See Cellular First Report and Order*, 6 FCC Rcd at 6228 ¶ 104.

[18] "As of the end of 2000, about ninety-one percent of U.S. residents lived in a county that was served, at least in part, by three or more different mobile telephony providers, and seventy-five percent of the U.S. population lived in a county where five or more providers offered service." 2000 Biennial Regulatory Review – Spectrum Aggregation Limits for Commercial Mobile Radio Services, WT Docket No. 01-14, Report and Order, ¶ 19 (2001) (*Second Biennial Review Order*), *available at* https://www.federalregister.gov/articles/2002/01/14/02-868/2000-biennial-regulatory-review-spectrum-aggregation-limits-for-commercial-mobile-radio-services.

[19] *See* Facilitating the Provision of Spectrum-Based Services to Rural Areas and Promoting Opportunities for Rural Telephone Companies to Provide Spectrum-Based Services, WT Docket No. 02-381, Report and Order and Further Notice of Proposed Rule Making, 19 FCC Rcd 19078, 19113-115 ¶¶ 63-67 (2004) (*Rural Report and Order*).

[20] *See* Amendment of the Commission's Rules to Establish New Personal Communications Services, Second Report and Order, 8 FCC Rcd 7700, 7728 ¶ 61, 7745 ¶ 106 (1993) (*PCS Second Report and Order*).

[21] *See PCS Second Report and Order*, 8 FCC Rcd at 7728 ¶ 61.

[22] *See PCS Second Report and Order*, 8 FCC Rcd at 7745 ¶ 106. *See also* Amendment of the Commission's Rules to Establish New Personal Communications Services, Memorandum Opinion and Order, 9 FCC Rcd 4957, 4984 ¶¶ 66-67 (1994).

spectrum cap,[23] and in 1996 the FCC decided to rely solely on that cap and eliminated the service-specific limitations on the aggregation of broadband PCS spectrum and on cellular/PCS cross-ownership.[24]

For much the same reasons, the FCC eventually moved away from spectrum caps to case-by-case adjudication. The FCC adopted the 45 megahertz spectrum cap on CMRS spectrum to promote diversity and competition in mobile services.[25] The theory was that a spectrum cap would be a "minimally intrusive means" to ensure competitiveness and innovation in the mobile communications marketplace, especially as compared with the sector-specific limitations and bans on cross-ownership described above.[26] A few years later, the FCC increased the cap to 55 megahertz in the rural areas and then to all markets during the sunset period.[27] In its Second Biennial Review Order, the FCC eliminated the spectrum cap in favor of case-by-case review, effective January 1, 2003.[28]

Finally, in 2008 the FCC extended the case-by-case review process to spectrum acquired via auction, *after* completing Auction 73.[29] This was not without controversy, as the FCC had stated it would consider spectrum aggregation in a service rules proceeding *before* it conducts an auction.[30]

2. Structure of the Two-Part Spectrum Screen

Since 2004, the FCC has used a two-part screen in order to identify potentially harmful transactions in which further competitive analysis would be necessary.[31] The FCC does not necessarily limit further

[23] Implementation of Sections 3(n) and 332 of the Communications Act – Regulatory Treatment of Mobile Services, GN Docket No. 93-252, Third Report and Order, 9 FCC Rcd 7988, 8100 ¶ 238, 8109 ¶ 263 (1994) (*CMRS Third Report and Order*).

[24] *See Second Biennial Review Order*, 16 FCC Rcd at 22673 ¶ 13 (citing Amendment of Parts 20 and 24 of the Commission's Rules – Broadband PCS Competitive Bidding and the Commercial Mobile Radio Service Spectrum Cap; Amendment of the Commission's Cellular/PCS Cross-Ownership Rule, WT Docket No. 96-59, Report and Order, 11 FCC Rcd 7824, 7869 ¶ 94 (1996), *aff'd*, 12 FCC Rcd 14031 (1997), *aff'd sub nom. BellSouth Corp. v. FCC*, 162 F.3d 1215 (D.C. Cir. 1999) ("[T]o ensure that multiple service providers would be able to obtain broadband PCS spectrum and thereby facilitate the development of competitive markets for wireless services.").

[25] Id.

[26] *See CMRS Third Report and Order*, 9 FCC Rcd at 7999 ¶ 16.

[27] *See First Biennial Review Order*, 15 FCC Rcd at 9254-57 ¶¶ 80-84; *Second Biennial Review Order*, 16 FCC Rcd at 22671 ¶ 6, 22693 ¶ 47.

[28] *See* 47 C.F.R. § 20.6(f); *Second Biennial Review Order*, 16 FCC Rcd at 22669 ¶ 1, 22696 ¶ 55; *Second Biennial Review Order*, 16 FCC Rcd at 22670-71 ¶ 6.

[29] *See* Union Telephone Company, Cellco Partnership d/b/a Verizon Wireless, Applications for 700 MHz Band Licenses, Auction No. 73, Memorandum Opinion and Order, 23 FCC Rcd 16787, 16791 ¶ 9 (2008) (*Verizon Wireless-Union Tel. Order*).

[30] *See Second Biennial Review Order* at ¶ 54; *see also* Fred Campbell, *Comments on the Mobile Spectrum Holdings* 4 (Sept. 28, 2012), http://test.driveinnovation.org/wp-content/uploads/2013/02/CLIP+-+filing-FCC-comments-mobile+spectrum+11+28+2012+FILED.pdf.

[31] *See, e.g.*, Applications of Cellco Partnership d/b/a Verizon Wireless and SpectrumCo LLC and Cox TMI, LLC for Consent to Assign AWS-1 Licenses, et al,. WT Docket No. 12-4, Memorandum Opinion and Order and Declaratory Ruling, FCC 12-95 (rel. Aug. 23, 2012) at ¶ 48 (*Verizon Wireless-SpectrumCo Order*); Application of AT&T Inc. and Qualcomm Incorporated For Consent to Assign Licenses and Authorizations, WT Docket No. 11-18, Order, 26

considerations to only those markets identified by the initial screen, though, and will do a more extensive analysis of a license transfer if the agency has other reasons to think there could be potential competitive harms.[32]

The first part of the screen considers changes in market concentration as a result of the transaction, using the Herfindahl-Hirschman Index (HHI).[33] This step requires looking at both the post-transaction HHI and the change in the HHI.[34] The second part examines the amount of suitable spectrum available for the relevant product market.[35] For those markets highlighted by one or both steps in the analysis, the Commission routinely conducts more detailed, market-by-market reviews to determine whether the transaction would result in an increased likelihood or ability for the combined entity to behave in an anticompetitive manner.[36] The case-by-case analysis considers variables that are important in predicting the incentives and ability of service providers to successfully reduce competition on price or non-price terms, and transaction-specific public interest benefits that may mitigate or outweigh any harms arising from the transaction.[37]

FCC Rcd 17589, 17602 ¶ 31 (2011) (*AT&T-Qualcomm Order*); Applications of AT&T Wireless Services, Inc. and Cingular Wireless Corporation For Consent to Transfer Control of Licenses and Authorizations, WT Docket No. 04-70, Memorandum Opinion and Order, 19 FCC Rcd 21522, 21552 ¶ 58 (2004) (*Cingular-AT&T Wireless Order*).

[32] *See, e.g.*, *Verizon Wireless-SpectrumCo Order*, FCC 12-95, at ¶ 48; *AT&T-Qualcomm Order*, 26 FCC Rcd at 17609-10 ¶¶ 49-50; Applications of AT&T Inc. and Centennial Communications Corp. For Consent to Transfer Control of Licenses, Authorizations, and Spectrum Leasing Arrangements, WT Docket No. 08-246, Memorandum Opinion and Order, 24 FCC Rcd 13915, 13946-48 ¶¶ 71-74, 13952 ¶ 85 (2009) (*AT&T-Centennial Order*); Applications for the Assignment of License from Denali PCS, L.L.C. to Alaska Digitel, L.L.C. and the Transfer of Control of Interests in Alaska Digitel, L.L.C. to General Communication, Inc., WT Docket 06-114, Memorandum Opinion and Order, 21 FCC Rcd 14863, 14898 ¶ 85 (2006).

[33] The Herfindahl-Hirschman Index (HHI), which is calculated by summing the squares of all provider subscriber market shares in any given market, is a commonly used measure of market concentration in competition analysis. *See Fifteenth Mobile Wireless Competition Report*, 26 FCC Rcd at 9707-08 ¶¶ 48-49.

[34] The HHI screen identifies for further case-by-case market analysis those markets in which, post-transaction, the HHI would be greater than 2800 and the change in the HHI would be 100 or greater, or the change in the HHI would be 250 or greater, regardless of the level of the HHI. The HHI screen has remained the same since the Commission adopted the case-by-case review process. *See Fifteenth Mobile Wireless Competition Report*, 26 FCC Rcd at 9708 n. 121.

[35] *See, e.g.*, *Verizon Wireless-SpectrumCo Order*, FCC 12-95, at ¶ 59.

[36] This Notice of Proposed Rulemaking does not address the part of our review that considers changes in market concentration based on HHI, but considers only our review of mobile spectrum holdings.

[37] *See* Applications of Cellco Partnership d/b/a Verizon Wireless and Atlantis Holdings LLC For Consent to Transfer Control of Licenses, Authorizations, and Spectrum Manager and De Facto Transfer Leasing Arrangements and Petition for Declaratory Ruling that the Transaction is Consistent with Section 310(b)(4) of the Communications Act, WT Docket No. 08-95, Memorandum Opinion and Order and Declaratory Ruling, 23 FCC Rcd 17444, 17460 ¶ 26 (2008) (*Verizon Wireless-ALLTEL Order*).

In recent years, the FCC has continued to change how it considers spectrum aggregation, including the spectrum screen itself. As detailed by former FCC Wireless Bureau Chief, Fred Campbell:[38]

- The FCC staff analysis of the withdrawn AT&T/T-Mobile merger (described more fully below) presumed spectrum aggregation had the potential to cause harm because the spectrum screen triggered an unprecedented number of markets, but the FCC did not establish a benchmark that would trigger this presumption.[39] Compare this to the FCC's 2007 position that the FCC must conduct a granular analysis of each market triggered by the screen to determine whether "harm is in fact likely."[40]
- In 2011, the FCC evaluated spectrum aggregation at the national level measured on a MHz*POPs basis, but did not establish a benchmark.[41] This measurement appears to have replaced the presumption in the Staff Analysis.
- In 2011, the FCC separately analyzed spectrum aggregation below 1 gigahertz, but did not establish a benchmark.[42] The FCC had not differentiated between spectrum above and spectrum below 1 GHz in its previous transaction reviews.[43]
- In 2012, the FCC altered the framework again by calculating nationwide spectrum holdings using a population-weighted average megahertz, but did not establish a benchmark.[44]
- In 2012, the FCC also eliminated the spectrum aggregation "safe harbor."[45]

Discussed below are the problems raised by the FCC's use of HHIs, its shifting spectrum screen and its methodology in its more detailed competition analyses to evaluate the anticompetitive potential of proposed transactions.

3. Use of Conditions in Spectrum Transactions

In approving transfers of spectrum, the FCC has frequently imposed conditions ostensibly aimed at minimizing the risk of post-merger consumer harm. The FCC's use of conditions extends beyond just the transfer of spectrum licenses, however. Under Section 310(d) of the Communications Act, the FCC has the authority to determine whether applicants have demonstrated that their proposed assignment of

---

[38] Campbell, *supra* at 4-5.

[39] *See* Staff Analysis and Findings, AT&T-T-Mobile, WT Docket No. 11-65 ¶¶ 45-47 (Nov. 29, 2011) (Staff Analysis).

[40] *See* Applications of AT&T Inc. and Dobson Communications Corporation, Memorandum Opinion and Order, FCC 07-196 ¶¶ 30, 39 (Nov. 19, 2007) (AT&T-Dobson).

[41] Application of AT&T Inc. and Qualcomm Incorporated, Order, FCC 11-188 ¶ 45 (Dec. 22, 2011) (AT&T / Qualcomm).

[42] *See id.* at ¶ 49 (Dec. 22, 2011).

[43] *See AT&T-Cingular*, at ¶ 81.

[44] *See* Applications of Cellco Partnership d/b/a Verizon Wireless and SpectrumCo LLC and Cox TMI, LLC, Memorandum Opinion and Order and Declaratory Ruling, FCC 12-95 ¶ 77 (Aug. 23, 2012) (SpectrumCo).

[45] *See id.* at ¶ 48.

licenses will serve the public interest, convenience, and necessity.[46] In theory, this authority enables the FCC to create and enforce narrowly tailored, transaction-specific conditions to ensure that the public interest is served by the transaction.[47] The problem, however, as detailed below in I.C.3, is that the FCC's use of these conditions is *not* always narrowly tailored or transaction-specific, and the lack of judicial review has allowed the FCC to leverage its discretionary review power over the transfer of licenses to demand concessions from companies extending far beyond what the law requires or permits.

C. The FCC Exceeds its Statutory Limits in the Transaction Review Process

In several ways the FCC's transaction review practices take it outside the rule of law. In the spectrum screen itself, the FCC routinely avoids an actual competitive analysis based upon consumer welfare, opting instead to rely on an outdated structural model with presumptions of harm depending on concentration levels. Combined with the FCC's imposition of the burden of proof on the transacting parties, this "structural presumption" gives the agency considerable discretion to thwart proposed transactions. Having established this authority, the FCC uses this leverage over the spectrum review process to require companies to commit to conditions that essentially allow the agency to regulate nearly every aspect of industry conduct without any real legal oversight.

Below, I.C.1 will describe the FCC's legal basis for reviewing transactions by the spectrum screen and requiring conditions. I.C.2 will explain how the FCC routinely transgresses its legal boundaries in the spectrum screen process. Then, I.C.3 will describe the ugly truth about the FCC's use of conditions – they are a legally dubious way of regulating entire industries by an agency threat model.

1. The FCC's Legal Basis for Review

The FCC's basis for reviewing both wireline and spectrum licenses comes from the Communications Act. Under Section 214(a) "No carrier . . . shall acquire or operate any line" without first obtaining from the FCC a certificate of public convenience and necessity.[48] Under Section 309(j)(3)(B), the FCC has the authority to review proposed license transfers in order to "promot[e] economic opportunity and competition and ensur[e] that new and innovative technologies are readily accessible to the American people by avoiding excessive concentration of licenses."[49] In its recent NPRM,[50] the FCC also pointed to Congressional acts making competition a fundamental goal of the nation's mobile wireless policy, [51] and

[46] 47 U.S.C. § 310(d).

[47] *See, e.g.*, *AT&T-Centennial Order*, 24 FCC Rcd at 13929 ¶ 30; *Verizon Wireless-ALLTEL Order*, 23 FCC Rcd at 17462 ¶ 29; *Sprint Nextel-Clearwire Order*, 23 FCC Rcd at 17581 ¶ 22.

[48] 47 U.S.C. § 214(a).

[49] 47 U.S.C. § 309(j)(3)(B).

[50] In the Matter of Policies Regarding Mobile Spectrum Holdings, WT Docket No. 12-269, Before the Federal Communications Commission at ___.

[51] *See* 47 U.S.C. § 332(a)(3), (c)(1)(C); Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993. *See also Fifteenth Mobile Wireless Competition Report* ¶ 3.

affirmations of the FCC's authority "to adopt and enforce rules of general applicability, including rules concerning spectrum aggregation that promote competition."[52]

The FCC's two-part spectrum screen is supposed to help the FCC identify those transactions meriting greater review. The screen itself is clearly within the FCC's authority to review the competitive effects of license transfers. In Part II below, however, we describe the flawed economic model that the FCC has chosen to adopt in its screen. In practice, while the screen itself is an appropriate exercise of agency authority, its application does not serve the public interest.

The Communications Act contemplates clear limitations on the FCC's scope of review. Section 310(d) of the Communications Act states that the FCC "may not consider whether the public interest, convenience, and necessity might be served by the transfer, assignment, or disposal of the permit or license to a person other than the proposed transferee or assignee."[53] Unfortunately, many opponents of mergers and acquisitions of spectrum have successfully encouraged the FCC to do exactly this.

The FCC has also defended its use of conditions. In its transaction reviews,[54] the FCC has pointed to Section 303(r) of the Communications Act, which authorizes the FCC to prescribe restrictions or conditions not inconsistent with law that may be necessary to carry out the provisions of the Act.[55] The FCC has also referenced section 214(c) of the Act, which authorizes the FCC to attach to the certificate "such terms and conditions as in its judgment the public convenience and necessity may require."[56]

The FCC has argued that its public interest authority gives it greater ability to impose conditions than if it were just a competition authority.[57] The FCC claims that its use of conditions has generally been aimed at remedying specific harms likely to arise from proposed transactions, or to ensure that promised potential benefits are realized.[58] The FCC has also stated that it generally will not impose conditions to remedy pre-

[52] Middle Class Tax Relief and Job Creation Act of 2012, Pub. L. No. 112-96, § 6404 (Spectrum Act).

[53] 47 U.S.C. § 310.

[54] *See, e.g.*, In the Matter of Applications of GCI Communication Corp., ACS Wireless License Sub, Inc., ACS of Anchorage License Sub, Inc., and Unicom, Inc. For Consent To Assign Licenses to The Alaska Wireless Network, LLC.

[55] 47 U.S.C. § 303(r). *See also, e.g.*, *AT&T-Qualcomm Order*, 26 FCC Rcd at 17600 ¶ 26; *AT&T-Centennial Order*, 24 FCC Rcd at 13929 ¶ 30; *Verizon Wireless-ALLTEL Order*, 23 FCC Rcd at 17463 ¶ 29.

[56] 47 U.S.C. § 214(c). *See also, e.g.*, *AT&T-Centennial Order*, 24 FCC Rcd at 13929 ¶ 30; *Verizon WirelessALLTEL Order*, 23 FCC Rcd at 17463 ¶ 29; *Sprint Nextel-Clearwire Order*, 23 FCC Rcd at 17581 ¶ 22.

[57] *See, e.g.*, *AT&T-Centennial Order*, 24 FCC Rcd at 13929 ¶ 30; *Verizon Wireless-ALLTEL Order*, 23 FCC Rcd at 17463 ¶ 29; *Sprint Nextel-Clearwire Order*, 23 FCC Rcd at 17581-82 ¶ 22.

[58] 47 U.S.C. § 303(r); *see, e.g.*, *AT&T-Qualcomm Order*, 26 FCC Rcd at 17600 ¶ 26; *AT&T/Verizon WirelessALLTEL Order*, 25 FCC Rcd at 8718 ¶ 25; *AT&T-Centennial Order*, 24 FCC Rcd at 13929 ¶ 30. We consider only those harms and benefits that are related to the Commission's responsibilities under the Communications Act and related statutes.

existing harms or harms that are unrelated to the transaction.[59] As we discuss below, however, the FCC often imposes conditions that have little to do with the transactions being considered.

2. The FCC Routinely Transgresses Its Authority in Transaction Reviews

While the FCC undeniably has authority to review the license transfers under the Federal Communications Act, its purview to review transactions is intentionally limited in substantive scope. The FCC only has authority over the spectrum licenses, not over other parts of the transaction. Further, as noted above, the FCC is supposed to only evaluate whether the public interest would be served by the parties at hand, and not consider whether the public interest would be better served by another party having such spectrum. Unfortunately, these legal limitations have not stopped opponents of specific transfers and the FCC from (1) considering the competitive effects of other parts of the transaction and (2) comparing whether the use of spectrum would be better used elsewhere than the party receiving the spectrum under the reviewed transaction.

For instance, the FCC attached competition-related conditions to joint marketing and other commercial agreements that were part of the overall transaction, but which did not include the transfer of licenses.[60] Activists successfully urged the FCC to extend its reach in the Verizon-SpectrumCo deal on the theory that the commercial agreements could influence the industry's competitive landscape. Whether those agreements have anticompetitive effect is properly the province of the Department of Justice. The competitive effect of those agreements is best measured under the strictures of antitrust law, and not by the FCC under its vague "public interest" standard.

In practice, the agency reviews entire transactions, not merely the transfer of licenses.[61] This is highly problematic. If the FCC can assert jurisdiction over other agreements that are part of a spectrum transaction as part of its public interest review, its authority over license transfers will become a license to regulate all aspects of business — duplicating merger review by the DOJ, but under a standard of review that lacks any clear limiting principles and analytical rigor. This is a recipe for certain mischief.

3. Improper consideration of hypothetical, alternate transactions

Another, common problem with the FCC's transaction reviews is that, despite being prohibited from considering alternative arrangements not before the Commission, this mode of review is not uncommon. In part, this is unsurprising: The FCC is not primarily an enforcement agency; it is a regulator. Its mode of interaction is regulatory, and it views its role as shaping the telecom industry, not merely enforcing certain statutory obligations on telecom firms. At the same time, there is, even in standard antitrust analysis, a reluctance to accept proffered procompetitive justifications for what might otherwise be an anticompetitive merger where the same procompetitive effects can be achieved through a less problematic means. While in standard merger review this may play only a marginal role in the ultimate outcome of a

[59] *See, e.g.*, *AT&T-Centennial Order*, 24 FCC Rcd at 13929 ¶ 30; *Verizon Wireless-ALLTEL Order*, 23 FCC Rcd at 17463 ¶ 29; *Sprint Nextel-Clearwire Order*, 23 FCC Rcd at 17582 ¶ 22.

[60]

[61] *See, e.g.*,

transaction review, at the FCC where demonstration of public interest (including, presumably, efficiencies) is an affirmative obligation of the parties, this limitation is potentially far more significant.

For example, in assessing the purported efficiencies in the SpectrumCo transaction, the FCC notes the following:

> We find that the proposed transfer of spectrum from SpectrumCo, Cox, Leap, and T-Mobile to Verizon Wireless would have some important public interest benefits. Most importantly, the transfers from SpectrumCo, Cox, and Leap would result in utilization of currently fallow spectrum to meet the rapidly growing public demand for mobile broadband capacity, and help the United States continue to lead the world in 4G deployment and development. Given that the current licensees are not utilizing the spectrum for any purpose and appear unlikely to do so in the future, this will provide significant public interest benefits. In addition, we find that the record supports a public interest benefit in the intra-market transfers of equal amounts of spectrum between Verizon Wireless and T-Mobile, as the rationalization of spectrum holdings would enable more efficient deployment and use of the spectrum.
>
> Based on our review of the pleadings, data, and documents, however, we also have concerns that Verizon Wireless has not, in the face of serious objections, sufficiently supported its claim that it will use all of the spectrum it proposes to acquire from SpectrumCo, Cox, Leap, and T-Mobile in the near term to enable its LTE network to support growing consumer demand for mobile broadband, absent more imminent build out deadlines.
>
> The documents indicate that Verizon Wireless may be [REDACTED]. However, these documents do not indicate that Verizon Wireless would need to deploy more than 40 megahertz of AWS-1 spectrum in any of these markets to meet capacity demands.
>
> While we do find that the transfers to Verizon Wireless would have some public interest benefits, we also recognize the serious concerns raised regarding Verizon Wireless's ability to use the spectrum it is acquiring and its actual need for the spectrum in the near term. In particular, we recognize the concerns that capacity-enhancing technical solutions such as small cell deployment should be adequately considered, given the limited amount of spectrum currently available for 4G mobile network deployment. If commenters' concerns are accurate that Verizon Wireless does not need the spectrum it is acquiring, at least in the near term, and the result is that Verizon Wireless does not in fact put the spectrum to use, the Applicants' asserted benefits would be undermined. As we discuss in the following section, however, in response to these concerns, Verizon Wireless has committed to undertake an aggressive build-out schedule of the spectrum it is acquiring

> through these transactions. We therefore find that we can substantially credit the public interest benefits claimed by the Applicants, as detailed above.[62]

What's most notable here is that the FCC would credit the parties' proposed efficiencies only if the deployment of spectrum occurred on a more rapid time-frame than one that a hypothetical alternate owner of the spectrum might use. Only through specific concessions is the claimed efficiency credited. This is both inappropriate in economic terms and plainly illegal.

As compared to the presumed non-use of spectrum in the status quo, even a slow deployment would be an improvement. To set as a baseline the essentially arbitrary deployment speed of some other theoretical purchaser of the spectrum is improper. Moreover, to the extent that purchase of the full amount of spectrum was essential to the deal's ability to offer the 40 MHz the FCC acknowledges will result in immediate benefit, it should be irrelevant that some portion of the transferred spectrum may not be immediately deployed.

Critics repeatedly claim that Verizon is "hoarding" spectrum — and has "enough for the short and medium term." But everyone agrees that spectrum is in short supply, and the "long term" will arrive as soon as this year—by which time little additional spectrum will likely be available and Verizon's current holdings will be inadequate.[63] Here critics claim that Verizon is paying $3.6 billion for spectrum it allegedly has no use for simply in an effort to prevent competitors from accessing it. But this would be an incredibly costly and risky strategy, and given spectrum realities, far less likely than the alternative explanation that Verizon simply needs more spectrum.

a) The FCC Violates Section 310(d) by Considering Imaginary Transactions

While it may well be true that other competitors similarly "need" the spectrum, the proper standard for the FCC's review is not what other transaction could conceivably occur but whether the one before it serves the public interest. Critics imply that this spectrum should remain in its sellers' hands so that the FCC may approve its sale to another theoretical party at some theoretical future date. While this sort of industrial policy is economically insidious, it is also illegal. Section 310(d) of the Federal Communications Act makes it clear that the Commission may review only the transaction before it, and not compare it to a hypothetical alternative use of the spectrum.[64] The Commission itself agrees that "Section 310(d) of the Act limits our consideration to the buyer proposed in an assignment application, and we cannot consider whether some other proposal might comparatively better serve the public

---

[62] Spectrum Co Order.

[63] Verizon, SpectrumCo and Cox, Joint Opposition to Petitions to Deny and Comments (March 2, 2012), http://apps.fcc.gov/ecfs/document/view?id=7021897886.

[64] "Any such application shall be disposed of as if the proposed transferee or assignee were making application under section 308 of this title for the permit or license in question; but in acting thereon the Commission may not consider whether the public interest, convenience, and necessity might be served by the transfer, assignment, or disposal of the permit or license to a person other than the proposed transferee or assignee. 47 U.S.C. § 310(d). Congress specifically intended this provision to preclude the Commission from such economic engineering by ensuring that it undertakes its reviews "as though no other person were interested in securing [the] permit or license." H.R. Rep. No. 82-1750 at 12 (1952).

interest."[65] By the proper standard, opponents must rather demonstrate that the public would be better served by the spectrum remaining in its sellers' hands — where, by the FCC's own practice and admission, it will not readily be deployed for public use at all.

In fact, it is surely the case that some of the current spectrum scarcity — of demand outstripping supply — is a function precisely of its ownership by private and government entities that under-utilize it. The value of a scarce resource is a function not only of its scarcity value, but also the opportunity cost of capital, which varies considerably depending on the capacity of its owners to exploit it. In other words, while Verizon believes it can make a greater return on these spectrum licenses than on the $3.9 billion it will cost to buy them, SpectrumCo and Cox value the licenses less, precisely because their capacity to earn returns from them are less than their capacity to earn returns from $3.9 billion in cash. For the deal's opponents or the FCC to intervene would contravene the public interest standard, ensuring instead that the licenses remain with owners less able to make efficient use of them.

Meanwhile, it appear that other firms, including deal opponent T-Mobile, were presented with the opportunity to purchase the spectrum at issue here but were similarly unable to meet the opportunity cost of purchasing it. As Comcast Executive Vice President David Cohen noted at a recent Senate hearing, "We engaged in discussions with virtually every wireless carrier in the country with regard to this spectrum," including T-Mobile.[66] At the same hearing, Charles Rule pointed out: "So far as I can tell from the opponents' filings there is no concrete alternative transaction, much less one that would have generated more output."[67]

While most of the critics' arguments center on the scarcity of spectrum and every competitor's need for it, little is said about differential ability to exploit spectrum. Verizon and AT&T both invest on the order of $20 billion per year in their networks.[68] Spectrum alone is useless if it isn't coupled with towers, switches, routers, security, maintenance, customer service, and risky investment in innovation to improve all of these. T-Mobile, flush with the prospect of new spectrum from the failed AT&T deal, for all its bluster in this case is still going to have a hard time coming up with the resources to make the costly and disruptive switch from 3G to HSPA+ (let alone LTE), and even more spectrum (and depleted cash) won't do much to help if it doesn't also come up with billions in capital and organizational capacity to build the infrastructure to use it.

---

[65] Citadel Communications Co., Ltd. and Act III Broad. of Buffalo, Inc., Memorandum Opinion and Order, 5 FCC Rcd 3842, 3844 ¶ 16 (1990).

[66] Maisie Ramsay, Comcast: We Tried to Sell AWS to "Virtually Every" U.S. Carrier, Wireless Week, March 22, 2012, available at http://www.wirelessweek.com/News/2012/03/business-Comcast-tried-to-sell-AWS-to-Virtually-every-US-carrier/.

[67] Charles Rule, Senate Judiciary Committee Hearing Testimony, "The Verizon/Cable Deals: Harmless Collaboration or a Threat to Competition and Consumers?", March 21, 2012, available at http://www.judiciary.senate.gov/hearings/hearing.cfm?id=8b30fa475a5089d793576cd94706f84e.

[68] Lance Whitney, AT&T data traffic doubling as users complain about throttling, CNET, Feb. 15, 2012, http://news.cnet.com/8301-1023_3-57378453-93/at-t-data-traffic-doubling-as-users-complain-about-throttling/?tag=mncol;txt.

4. Consideration of Transactions Outside the Scope of the FCC's Authority

Under § 310(d) the FCC is limited to reviewing only license transfers themselves and not "ancillary" or "accompanying" transactions: "No construction permit or station license, or any rights thereunder, shall be transferred, assigned, or disposed of in any manner … to any person except upon application to the Commission and upon finding by the Commission that the public interest, convenience, and necessity will be served thereby … in acting thereon the Commission may not consider whether the public interest, convenience, and necessity might be served by the transfer, assignment, or disposal of the permit or license to a person other than the proposed transferee or assignee."[69] By its clear language the statute authorizes the Commission to assess only license transfers for their effect on the public interest.

In any transfer of FCC licenses, the Commission must decide whether the purchase of spectrum is in the "public interest." But the FCC has no authority to review separate commercial arrangements, even if they are related to the license transfer. These agreements, instead, can and should be evaluated by the Department of Justice under the consumer welfare standard of antitrust law.

The FCC has repeatedly declined to consider — until its review of the SpectrumCo transaction — commercial agreements accompanying license transfers. Thus the agency declined to consider a related agreement in the AT&T-Centennial transaction, noting that "we agree with the Applicants that the Agreement constitutes a private contractual matter between New Cingular Wireless and Cellular South that is beyond the Commission's jurisdiction."[70] Likewise the agency did not assess the commercial arrangements surrounding the Sprint Nextel-Clearwire transaction.[71]

It is almost certainly the case that the FCC engaged in an inappropriately wide-ranging review of the SpectrumCo transaction as a means of leveraging its transaction review power to exert extra-legal oversight over significant players in the telecom (and spectrum, particularly) realm. Moreover, it is probably worth noting that several advocacy groups and competing firms urged the agency to undertake this expansive review.

In SpectrumCo, the transfer of spectrum between, among others, Comcast, Cox Enterprises and Verizon, was accompanied by a set of commercial agreements, including a joint research venture and a number of marketing agreements. Even if the commercial agreements were executed at the same time as the license transfer and even if, as at least one of the parties has claimed,[72] the agreements were necessary to their decision to undertake the license transfer, they were not properly reviewed as part of the spectrum transfer.

---

69 47 U.S.C. § 310(d).

70 AT&T-Centennial Order, 24 FCC Rcd at 13976 ¶ 152.

71 Press Release, "Clearwire, Sprint and Clearwire to combine WiMAX businesses, creating a new mobile broadband company," (May 7, 2008), available at http://corporate.clearwire.com/common/download/download.cfm?CompanyID=CLWR&FileID=442757&FileKey=0556727d-310e-4cae-abf5-48824fdd8098&FileName=CLWR_News_2008_5_7_General_Releases.pdf.

72 Bright House Networks, Response to "Information and Discovery Request for Bright House Networks" (March 22, 2012), http://apps.fcc.gov/ecfs/document/view?id=7021902927.

Among other things, the spectrum licenses involved were being transferred from Comcast and Cox to Verizon. None of the commercial agreements dealt with, discussed or in any way turned on decisions respecting the use of the transferred spectrum. The spectrum licenses did not become part of the joint venture, and the transferors did not retain any interest in or special access to them. Instead, the joint research agreement contemplated the formation of a new entity, Joint Operating Entity, LLC, relating to entirely different assets and aspects of the applicants' businesses.

Deriving authority to review these agreements from its undisputed jurisdiction over the license transfer is tantamount to granting the FCC authority to review conduct wholly outside of its legal purview and expertise. By the this logic, if Company A agrees to sell licenses to Company B and, at the same time, Company A's COO agrees to join Company B as its new CEO to help build out its new assets, the FCC would have the authority to scrutinize the COO's new compensation package and employment agreement as "relevant to the proceeding." But this is fanciful on its face, no matter how much the COO's employment is conditioned on the sale going through and his compensation explicitly tied to his success in deploying Company B's new assets. It would be a bastardization of the English language to say these two transactions weren't related and "relevant" to each other; but it would be a subversion of the law to say this brings them both under the FCC's authority.

Moreover, at the same time, it may well be that the transactions were "related" in that collectively they offered value in return for spectrum necessary to induce Comcast and Cox to sell. In other words, they were related in the way that price is related to any license transfer. But it appears that the FCC has never questioned the price of a transfer as part of its analysis — even though this could have competitive effects just as the agreements in SpectrumCo were purported to. Plenty of things could conceivably have "competitive effect" and be "related to" a license transfer, but they don't fall under the FCC's limited substantive purview under Section 310(b) as a result.

Consideration of the competitive effects of the agreements like those accompanying the license transfer in SpectrumCo is, however, appropriately under the DOJ's purview. For the FCC to assert that its own review of the same transactions was necessary to preserve the public interest is to denigrate the capacity of the Antitrust Division and the very structure of the federal government. As former FCC Commissioner Harold Furchgott-Roth has aptly noted:

> We have no jurisdiction to enforce rules not promulgated under the Communications Act …, and we cannot and should not do the enforcement work of others. This is not to say that we should not take official notice, in the course of making licensing decisions, of findings by another agency that an applicant has violated a regulation in its bailiwick. We should certainly consider such findings in determining whether to grant or deny a license application. But we should not condition such a decision on compliance with another agency's regulation, thus putting ourselves in the position of potential enforcer of non-FCC rules should the transferee fail to conform to that regulation ….

> When we give formal weight to anything short of formal, final findings by other agencies, we create a situation that is rife with incentives for inter-agency gaming of the system, *e.g.,* registering an objection with an agency about a matter that the complaining agency is not prepared to pursue itself, and requires the Commission to do extensive reviews in areas where it simply has no experience or authority.[73]

Commissioner Pai in his concurrence in SpectrumCo asserts much the same thing, noting that "Congress limited the scope of our review to the proposed transfer of spectrum licenses, not to other business agreements that may involve the same parties."[74]

The FCC in defending its purported authority mustered literally nothing to support its claim. The agency's legal analysis on the issue reads in its entirety: "The Commission has authority to review the Commercial Agreements and to impose conditions to protect the public interest."[75] There's not even an accompanying footnote.

Footnote 349 of the FCC's Order comes close to providing some additional explanation, but it falls flat because it does not offer any support for the FCC's authority under 310(d). Footnote 349 begins with the phrase, "[a]side from Section 310(d)…." It is no surprise, then, that the footnote contains no analysis of the agency's authority under that section. The FCC's authority under 310(d) is precisely what is at issue here. The question was raised and argued in several submissions to the Commission (including ours), and the Commission is clearly aware of this.

But 310(d) is the relevant provision. In paragraph 142 of the FCC's Order, the agency notes the parties' objection to its review of the agreements: "Verizon Wireless and the Cable Companies respond that the Commission should not review the Commercial Agreements because… the Commission does not have authority to review the agreements." That objection, rooted in 310(d), was to the Commission extending its transaction review authority (unquestionably arising under only 310(d)) beyond that section's limits. The Commission then answers the parties' claim in the next paragraph with the language quoted above. It seems clear that the FCC's unequivocal, unsupported statement of authority is a statement of authority under 310(d). This is as it should be. The FCC's transaction review authority is limited to Section 310(d). Thus if the agency were going to review the Commercial Agreements as part of the transfer, the authority to do so must come from 310(d) alone.

For the Commission to justify its review of the agreements, it needed to provide analysis on how exactly 310(d), despite appearances, gave it the authority to do so. It does not.

The Commission did cite to several other sections of the Communications Act in the paragraph (145) that includes footnote 349. But that paragraph relates not to the review of the transaction itself (or even the

---

[73] Separate Statement of Commissioner Harold Furchgott-Roth in Re: Applications for Consent to the Transfer and Control of Licenses and Section 214 Authorization from Tele-Communications, Inc., Transferor, To AT&T Corp., Transferee, CS Docket No. 98-178, http://transition.fcc.gov/Speeches/Furchtgott_Roth/Statements/sthfr906.html.

[74] [CITE to Pai Concurrence in SpectrumCo].

[75] [SpectrumCo].

ability of the parties to enter into the commercial agreements) but to the Commission's authority to ensure that Verizon *complies* with the conditions imposed on the transaction, and to monitor the possible effects the agreements might have on the market after the fact.

Three of the four statutes cited in the footnote (47 U.S.C. §§ 152, 316, & 548) don't appear to give the Commission authority for anything related this transaction. Only 47 U.S.C. § 201 is conceivably relevant. But having authority to monitor a wireless provider's post-transaction business practices is far different from having the authority to halt or condition the transaction itself before its completion because of concerns about ancillary agreements. The FCC cites no statutes to support this authority — because none exist.

This is not simply a semantic distinction. By claiming authority to review ancillary agreements in the course of reviewing license transfers, the Commission gains further leverage over companies seeking license transfer approvals, putting more of the companies' economic interests at risk. This means companies will more likely make the "voluntary" concessions (with no opportunity for judicial scrutiny) that they would not otherwise have made — or they might not enter into deals in the first place. The difference between the FCC reviewing the commercial agreements in deciding whether to permit the license transfer (or demand concessions) and regulating the agreements after the fact is no mere formalism.

Of course, sometimes big really *is* bad. The central challenge for policymakers is ensuring they don't erroneously thwart beneficial deals and instead run afoul of Ronald Coase's lament: "if [a regulator] finds something — a business practice of one sort or other — that he does not understand, he looks for a monopoly explanation."[76] It is for this reason, in theory, that we limit agencies' authority to review deals.

But accepting the limits Congress has imposed on the FCC doesn't require approving the SpectrumCo deal, or any other. The DOJ is perfectly willing to use antitrust to block such deals. The key difference, as we discuss more fully below, is that DOJ can block or condition approval of a deal only if it shows the deal would substantially harm consumer welfare. And DOJ bears the burden of showing this harm, measured against extensive case law and economic analysis. Parties before the FCC, on the other hand, bear the burden of demonstrating that their transactions enhance competition and serve the "public interest." That phrase "lacks any definite meaning," as Ronald Coase noted more than 50 years ago.[77]

The concern is that, as industry evolves and competitors vie for scarce resources (especially in wireless broadband), they meet new competitive challenges with novel business arrangements and increased investment. Economies of scale may become more important, and concentration may increase, benefiting, rather than harming, consumers. But the FCC seems willing (and able) to act beyond its authority to condemn these actions as anticompetitive or against the public interest, without actually having to prove it.

[76] CITE Coase.

[77] CITE Coase.

5. *The FCC's Extralegal Use of Transaction Conditions*

One of most problematic aspects of the FCC's transaction review process is how the FCC uses its power to demand "voluntary" concessions from companies and attaching conditions unrelated to the competition review in the screen.

Transactions that are approved often come with comically long lists of conditions, including divestitures of some customers and/or spectrum, as well as wildly unrelated remedies.[78] For Comcast-NBCUniversal, the conditions ran to nearly thirty pages, including (i) a requirement that Comcast adhere to net neutrality even if the Open Internet Order is overturned, (ii) rate regulation on Comcast's broadband service, and (iii) specific requirements on what channels Comcast offers in its cable packages.

The Commission asserts the authority to negotiate and enforce conditions on license transfers under 47 U.S.C. § 303(r), which gives the FCC the authority to "prescribe such restrictions and conditions, not inconsistent with the law, as may be necessary to carry out the provisions" of the act.[79] In each case where the FCC has imposed conditions, even though they frequently bear little or no relationship to the competitive issues created by the license transfer under review, the Commission has claimed that, absent the commitments, the proposed transactions would have resulted in significant public interest harms, leading the agency to reject the transaction. Because the FCC's standard of review is so broad, transacting parties bear the burden of proving the benefits of their case before the FCC itself, and the FCC's decision receives substantial deference in court (and is almost never appealed), this threat is enormously powerful, and the Commission is able to extract a wide range of "voluntary" concessions. As others have noted:

> [I]mposing (and threatening to impose) significant conditions when firms seek to repurpose spectrum from a low-value to a higher-value use acts as a "tax" and thus reduces the incentives of firms to exchange spectrum in the secondary market. As a result, "taxation by condition" will discourage the larger scale transactions necessary to resolve spectrum exhaust, though we may still observe many deals of a less material nature that will attract less attention and thus fewer conditions.[80]

In effect, the agency uses transaction reviews to impose the kinds of regulations that would otherwise require a formal rulemaking. In addition to side-stepping notice-and-comment requirements, this regulation-by-merger-condition creates a crazy quilt where different rules apply to different companies, sometimes in different markets. For instance, when the FCC approved the SpectrumCo transaction, one of the conditions was a data roaming rule. Verizon (but not its competitors) will be subject, for five years, to these obligations – much as Comcast "voluntarily" agreed to net neutrality conditions in its merger with NBCUniversal even stricter than the regulations the D.C. Circuit seems likely to strike down for everyone

---

[78] *See, e.g.*, [CITE]

[79] The FCC also asserts authority under sec. 214(c), which grants the Commission the power to place "such terms and conditions as in its judgment the public convenience and necessity may require" on the certificates the agency issues pursuant to its license transfer review authority.

[80] Beard, et al., *Taxation by Condition: Spectrum Repurposing at the FCC and the Prolonging of Spectrum Exhaust*, Phoenix Center Policy Paper No. 44 (September 2012) at 1.

else.[81] This creates a patchwork of rules and obligations, coerced without sound economic justification, in a fashion largely unreviewable by courts, and in contravention of limits placed on the FCC's authority by Congress and the courts. Consumers can't be expected to understand why different rules apply to different products and services. Future transactions are needlessly complicated, with the industry experiencing increased regulatory uncertainty.

In addition to these costs, the FCC's process and its interpretation and exercise of its authority to impose conditions leads to harmful rent seeking. As Hal Singer has noted, "the FCC's discretion to hold up telecom mergers in return for behavioral remedies invites 'rent seeking' activity by competitors, who use the FCC's merger review as a basis to lobby for welfare-reducing obligations on their rivals."[82]

III. THE FCC'S OUTDATED ECONOMIC MODEL FOR TRANSACTION REVIEWS

Aside from the legal problems described above, the FCC's transaction review process is problematic because it reduces consumer welfare. The FCC's current use of the spectrum screen, in particular, is premised on the outdated model of structural presumptions long-rejected in antitrust analysis. While HHI and spectrum concentration metrics could be helpful in an actual screen for fuller analysis based on consumer welfare, the FCC's current full analysis is little more than an extended structural presumption. Meanwhile, there is plenty of *direct* evidence of competitive conditions in these markets—including prices, broadband speeds, number of users, churn, advertising expenditure, innovation, infrastructure investment, and more—more than enough for the agency to perform a far more reliable and realistic, data-driven analysis of the costs and benefits to the public interest of proposed transactions.

The FCC already collects most of the data needed for that kind of evaluation as part of its regular reports on mobile competition, broadband deployment, and video competition.[83] Indeed, that data is the basis on which the agency, by its own rules, is already supposed to weigh the costs and benefits of requested license transfers. But meaningful, data-driven analysis has given way to increased deference to a mechanical formula without meaning or objectivity, masking the absence of real analysis or cynically justifying a conclusion already reached.

The following section describes the FCC's current spectrum screen in more detail, comparing the FCC's reliance on HHI and spectrum concentration metrics to the outdated structural presumptions of antitrust law and explains the flaws in the FCC's current economic analysis.

A. The FCC Improperly Relies upon HHI and Spectrum Concentration Metrics to Create a per se Presumption that Certain Transactions are Illegal

[81] Cite to Open Internet Order DC Circuit case.

[82] Hal Singer, Which Way Will Tom Wheeler Take the FCC: Follow the Blog Trail, Forbes (May 6, 2013), *available at* http://www.forbes.com/sites/halsinger/2013/05/06/which-way-will-tom-wheeler-take-the-fcc-follow-the-blog-trail.

[83] See, e.g., Larry Downes and Geoffrey A. Manne, "FCC Mobile Competition Report is One Green Light for AT&T/T-Mobile Deal," BNA Daily Report for Executives, 132 DER B-1, July 11, 2011.

The FCC describes its process for reviewing mergers (involving the transfer of spectrum licenses) thusly:

> In our review of applications involving a proposed transaction, the Commission evaluates the potential public interest harms, including potential competitive harms, that may result from the transaction. Transactions raise potential competitive concerns when the post-transaction entity has the incentive and the ability, either by itself or in coordination with other service providers, to raise prices, lower quality, or otherwise harm competition in a relevant market. The Commission's competitive analysis of wireless transactions focuses initially on markets where the acquisition of customers and/or spectrum would result in additional concentration of either or both, and thereby potentially lead to competitive harm. The Commission has used a two-part initial screen to help identify local markets where changes in market concentration or spectrum holdings from the transaction may be of particular concern. As discussed below, the initial screen's comparison of subscriber shares and spectrum holdings before and after the proposed transactions would identify no changes in any markets. Regarding Sprint's acquisition of Clearwire, Clearwire's spectrum and customers already are attributed to Sprint under the attribution policies the Commission uses in applying the initial screen. Regarding SoftBank's acquisition of both Sprint and Clearwire, SoftBank has no customers or spectrum in the United States.[84]

That's the theory, anyway. In practice, however, the FCC's review of transactions involving the transfer of spectrum licenses is frequently dramatically different.

1. The FCC's Spectrum Screen in Practice

The FCC transaction reviews lack analytical rigor, as evidenced by pseudo-mathematical calculations, arbitrary adjustments, and catch-all "transaction-specific public interest factors" applied to mask decisions actually made by the agency.

The first part of the screen, which uses the Herfindahl-Hirschman Index (HHI) to assess the change in market concentration as a result of a proposed transaction, no longer makes sense. Modern economic analysis has shown that HHIs (and other concentration measures) are not reliable tools for measuring competitive effects in dynamic markets with rapidly developing technologies.[85] The economic theory supporting the use of HHIs suffers from the same analytical problem underlying the FCC's analysis of spectrum transactions as a whole: They both rest on the outdated "structural presumption" that high levels of concentration in a market leads to anticompetitive prices and harm to consumers.

---

[84] In the Matter of SoftBank Corp, et al. for Consent to Transfer Control of Licenses and Authorizations, Memorandum Opinion and Order, IB Docket No. 12-343, July 5, 2013, *available at* http://transition.fcc.gov/Daily_Releases/Daily_Business/2013/db0724/FCC-13-92A1.pdf.

[85] See, e.g., Michael L. Katz & Howard A. Shelanski, *Mergers and Innovation*, 74 ANTITRUST L.J. 1, 22 (2007) ("[T]he literature addressing how market structure affects innovation (and vice versa) in the end reveals an ambiguous relationship in which factors unrelated to competition play an important role."); J. Gregory Sidak & David F. Teece, *Dynamic Competition in Antitrust Law*, 5 J. COMPETITION L. & ECON. 581, 588 (2009) ("[D]espite 50 years of research, economists do not appear to have found much evidence that market concentration has a statistically significant impact on innovation.").

The spectrum screen was designed to measure the impact of a proposed transaction on spectrum holdings in each of several hundred local markets. It purports to simplify the application process of the transaction by creating a simple rule: if the merged entity would control less than a third of the usable spectrum allocated to commercial mobile applications in a given market, the market is presumed to be competitive and no further analysis is performed. The transaction thus passes the screen.

For those markets where the screen fails, the Commission performs a competitive analysis of the proposed transaction. In this study, likely costs to the "public interest" are weighed against likely benefits from the proposed transfer. The Commission then makes a judgment based on the balance of these two criteria.

For each of the markets assessed in this analysis, the FCC updates the total usable spectrum. Depending on changes in technology and previous spectrum reassignments, the formula's numbers are adjusted further to take into account the different technical characteristics of different bands, which can be more or less useful for different applications depending on the frequency. The amount is further adjusted depending on the ownership of subsidiaries that similarly own swaths of the spectrum. Each transaction, therefore, is subject to different versions of the screen, which is adjusted unpredictably at the time of review.

Different transactions, therefore, are subject to different versions of the screen. The agency is unbound by any concrete formula for its specific adjustments, and no party knows ahead of time — or at the time it submits a request for license transfer — what the screen's key inputs will look like when negotiating an acquisition.

Even more problematic, the benefits of low-frequency spectrum in the determination of the screen have been assumed without further discussion. To be clear, the lower end of the spectrum does allow wireless providers greater range over higher-frequency spectrum.[86] Fewer towers are thus required to cover an area with low-frequency spectrum than would be needed to cover the same area with high-frequency spectrum.[87] Obviously, this is an advantage, but it has been much overstated. Today's wireless market is less constrained by coverage than capacity. The advantages of low-frequency spectrum have eroded for the contemporary wireless market, particularly in highly concentrated areas where capacity is severely strained. The FCC did issue a Notice of Proposed Rulemaking aimed at clarifying the process, but the Commission's goals are unclear. As Commissioner Pai pointed out, the NPRM did not actually propose any rules.[88]

2. The Faulty Economics of the Spectrum Screen

[86] See FCC, Fifteenth Mobile Wireless Competition Report, para 292, *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-11-103A1.pdf.

[87] *Id.* at para 293.

[88] Statement of Commissioner Pai, In the Matter of Policies Regarding Mobile Spectrum Holdings, WT Docket No. 12-269, Before the Federal Communications Commission.

In its less regulatory (and more self-congratulatory) moments, the FCC has paid lip service to moving away from these simplistic tools used to evaluate industry competitiveness. The FCC's 15th Wireless Competition Report repeatedly de-emphasizes the HHIs, which tend to understate competition, and downplays the value of spectrum screens.[89] As we'll see, this bit of economic realism does not translate into the agency's actual regulatory practice.

As far as the screen is concerned, there's no evidence that a carrier that controls more than a third of the usable spectrum in a market has the ability to inflict harm on consumers. In essence, the screen is based on the notion that an increase in the number of wireless providers will yield lower prices or benefits to consumers. But the data consistently show that wireless markets have seen considerable increases in the relative concentration of the industry, accompanied not by consumer harm but by lower prices and increasing output indicative of a highly competitive market.[90] The central problem for the industry is the relative scarcity of the input. According to the Fifteenth Report, "mobile broadband growth is likely to outpace the ability of technology and network improvements to keep up by an estimated factor of three, leading to a spectrum deficit that is likely to approach 300 megahertz within the next five years."

Both HHIs and the spectrum screen are born of the same outdated structural presumption that infers anticompetitive effects from high levels of concentration. But in markets characterized by technological innovation, multidimensional competition and economies of scale, the reality is that we have no idea what level of concentration is commensurate with optimal outcomes. As Harold Demsetz has put it:

> [o]nce perfect knowledge of technology and price is abandoned, [competitive intensity] may increase, decrease, or remain unchanged as the number of firms in the market is increased . . . . [I]t is presumptuous to conclude . . . that markets populated by fewer firms perform less well or offer competition that is less intense.[91]

And as former FCC economists Michelle Connolly and James Prieger have explained,

> [t]raditional market definition analysis, based on whether a firm's price is constrained by existing competitors, can give a seriously misleading picture of competitive relations in dynamic markets with rapidly developing technology."[92]

These fundamental concepts have increasingly made their way into the regulatory realm, at least in that of traditional antitrust. Thus the DOJ now downplays the value of a structural presumption (at least in *its* less-regulatory moments), especially in the broadband ecosystem:

---

[89] CITE 15th Wireless Competition Report.

[90] Gerald R. Faulhaber, Robert W. Hahn, & Hal J. Singer, *Assessing Competition in U.S. Wireless Markets: Review of the FCC's Competition Reports* (Working Paper Jul. 21, 2011), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1880964.

[91] Harold Demsetz, The Intensity and Dimensionality of Competition, in THE ECONOMICS OF THE BUSINESS FIRM: SEVEN CRITICAL COMMENTARIES 137, 140-41 (1995)

[92] Michelle Connolly & James Prieger, Economics at the FCC, 2008-2009: Broadband and Merger Review, 35 Rev. Indus. Org. 387, 404 (2009).

> We do not find it especially helpful to define some abstract notion of whether or not broadband markets are "competitive." Such a dichotomy makes little sense in the presence of large economies of scale, which preclude having many small suppliers and thus often lead to oligopolistic market structures. The operative question in competition policy is whether there are policy levers that can be used to produce superior outcomes, not whether the market resembles the textbook model of perfect competition.[93]

And under the Merger Guidelines,

> [t]he purpose of these [HHI] thresholds is not to provide a rigid screen to separate competitively benign mergers from anticompetitive ones, although high levels of concentration do raise concerns. Rather, they provide one way to identify some mergers unlikely to raise competitive concerns and some others for which it is particularly important to examine whether other competitive factors confirm, reinforce, or counteract the potentially harmful effects of increased concentration. The higher the post-merger HHI and the increase in the HHI, the greater are the Agencies' potential competitive concerns and the greater is the likelihood that the Agencies will request additional information to conduct their analysis.[94]

For antitrust review, HHIs help determine "the likelihood that the Agencies will request additional information."[95] This is far from a presumption of harm. Even where the Merger Guidelines do begin to draw inferences from certain degrees of concentration and/or increases in concentration, they infer only "the creat[ion] or enhance[ment] of market power"—not anticompetitive outcomes.

By contrast, rigid HHI calculations, rooted in the assumption that concentration levels that exceed a certain threshold are presumptively anticompetitive, are improper, and the history of market performance contradicts this assertion. While market concentration has increased, prices have decreased, indicating increased competition despite the fact that there may be fewer competitors present.

Despite the manifest need for spectrum transfers on the secondary market, the FCC has stood steadfast in preserving an outdated model of evaluating mobile spectrum holdings that prevents wireless providers from expanding their networks, to the detriment of consumers. Simply having more competitors in a market does not necessarily result in lower prices and better service for consumers, particularly in an industry like wireless that requires a massive investment in infrastructure and the acquisition of viable bands of spectrum just to get off of the ground.

Moreover, merely possessing spectrum licenses is only a small fraction of what it takes to succeed in the wireless industry. Making effective use of that spectrum requires towers, switches, routers, security,

---

[93] Ex Parte Submission of the United States Department of Justice, "In the Matter of Economic Issues in Broadband Competition," GN Docket 09-51, Jan, 4, 2010.

[94] DOJ/FTC Joint Horizontal Merger Guidelines at 19 (2010), *available at* http://www.ftc.gov/os/2010/04/100420hmg.pdf.

[95] Id.

maintenance, customer service, innovation and risky investment in all of these. These are the factors that set the largest wireless carriers (AT&T and Verizon) apart from the competition—not merely, as their critics would have it, their spectrum share or market capitalization. They may be the two largest holders of wireless spectrum, but they have also invested substantially more in their network infrastructure than other carriers, built out faster and more geographically-broad service, worked with device manufacturers to ensure compatibility, invested in quality control and maintenance capacity to minimize network outages, developed and employed advanced network management tools, and a whole host of other ancillary services all of which are necessary to delivering effective mobile broadband services. Assessing competitive effects in such circumstances with reference essentially solely to the size of these companies, the extent of their spectrum holdings, and the number of current competitors they face is misguided.

The FCC's structural approach is thus at odds with modern economic analysis, which significantly downplays the importance of concentration measures as indicia of competitive effects.

3. After the Spectrum Screen: "Further Competitive Analysis"

When the spectrum screen is triggered by a transaction, the FCC must conduct "further competitive analysis" to determine if the transaction's pro-competitive benefits outweigh its potential anticompetitive harms. In concept, this seems like a sound method, akin to an antitrust analysis, for determining whether to approve, reject, or place conditions on a transaction. However, because there are no statutory guidelines for how this competitive analysis should be conducted, the analysis has been applied inconsistently from transaction-to-transaction, and often comes up well short of what a full-blown competitive analysis should look like. Specifically, the determination of anticompetitive harms has become little more than a more elaborate evaluation of market shares and spectrum concentration, which is essentially just reiterating, in slightly more detail, what we already knew from the triggering of the spectrum screen in the first place. It thus implies that market concentration leads directly to consumer harm without any further competition analysis.

It hasn't always been this way, however. Not long ago there was a time when the FCC's competition review was comprehensive and focused on factors beyond concentration. Shortly after the FCC switched from a hard cap of spectrum ownership to the current screen, there were two major wireless mergers that required FCC approval: AT&T-Cingular and Sprint-Nextel. Both mergers triggered the spectrum screen in some markets and thus were subject to further competitive analysis.

In the AT&T-Cingular merger order,[96] the FCC does dedicate five pages of its review to market concentration,[97] but it then spends its next seventeen pages discussing horizontal issues such as unilateral effects and coordinated interaction[98] and another seven pages assessing vertical issues like roaming and special access.[99] The FCC even acknowledges that market concentration is only one piece of the puzzle to

---

[96] AT&T / Cingular Order, *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-04-255A1.pdf.

[97] Id. at paragraphs. 95-112.

[98] Id. at paragraphs 113-164.

[99] Id. at paragraphs 165-183.

determining whether the merger is anticompetitive when it says, "a calculation of the HHI in a market is only the beginning of our analysis of the competitive effects of the merger, because its purpose is to eliminate from further analysis markets in which there is no potential for competitive harm. In our analyses of potential unilateral effects, coordinated interaction, and vertical issues, above, we have undertaken a general assessment of factors beyond concentration that are important to determining likely competitive effects of the merger."[100]

The FCC's evaluation of the Sprint-Nextel merger is similarly impressive.[101] Following the model laid out in the AT&T-Cingular merger order, the Commission dedicates fourteen pages[102] to its analysis of coordinated interaction and unilateral effects. Factoring in vertical and horizontal effects along with a concentration analysis, the FCC finds that neither of the transactions is expected to result in any competitive harm, despite the increased concentration in the market.[103]

Now contrast the approach the FCC used in those merger reviews in 2004-2005 with how the Commission has conducted its competitive analysis in more recent spectrum transactions. The FCC's 2008 review of the Verizon-Alltel merger used a much less robust analysis than the one it used three years prior.[104] The discussion of unilateral and coordinated effects is given a paltry three pages,[105] and can barely be qualified as an "analysis" at all; the FCC merely notes that that a merger like this could potentially have such effects. Instead, the review focuses almost exclusively on market concentration, and the Commission inadvertently admits as much when it lays out the factors it purports to consider in conducting its analysis:

> the total number of rival service providers; the number of rival firms that can offer competitive nationwide service plans; the coverage of the firms' respective networks; the rival firms' market shares; the merged entity's post-transaction market share and how that share changes as a result of the transaction; the amount of spectrum suitable for the provision of mobile telephony/broadband services controlled by the combined entity; and the spectrum holdings of each of the rival service providers."[106]

Far from encompassing a robust competitive effects analysis, these factors are merely a more elaborate version of the mechanical concentration analysis embodied in the spectrum screen and HHI calculations. Relying solely on spectrum and market concentration, the FCC concludes that there is "significant likelihood of harm in the proposed transaction, either from unilateral effects or coordinated interaction, in five of the 118 CMAs identified by the initial screen."[107] The FCC's basis for this conclusion is that these

[100] Id. at paragraph 184.

[101] Sprint / Nextel Order, *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-05-148A1.pdf.

[102] Id. at paragraphs 68-116.

[103] Id. at paragraph 119; AT&T / Cingular Order at paragraph 184.

[104] Verizon / Alltel Order, *available at*, http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-08-258A1.pdf.

[105] Id. at paragraphs 84-90.

[106] Id. at paragraph 91.

[107] Id. at paragraph 93.

are markets "in which the transaction would reduce the number of genuine competitors to three or fewer."[108] The Commission's entire competition analysis covers eleven pages, compared to twenty-nine in the AT&T-Cingular merger.

The Verizon-SpectrumCo transaction review also left a lot to be desired in terms of competition review.[109] The Order doesn't even contain a separate analysis of unilateral or coordinated effects, and instead the entire competitive analysis is a discussion of the spectrum concentration that would occur as a result of the transaction. Relying solely on claims of increased spectrum concentration, the FCC concludes that "Verizon Wireless's acquisition of a substantial amount of AWS-1 spectrum from SpectrumCo, Cox, and Leap in numerous local markets causes significant competitive concerns."[110]

Even when the FCC appears to conduct a more comprehensive competition review today, the end result ultimately demonstrates the inconsistency and unpredictability of the FCC's competitive analysis. The Wireless Telecommunications Bureau's Staff Analysis and Findings of the failed AT&T/T-Mobile merger (discussed in significant detail below) initially appears to be a step in the right direction for the FCC.[111] The agency dedicates over 50 pages to its competitive analysis, over twenty of which focus on the unilateral and coordinated effects of the merger.[112] But what ultimately appears to doom the merger is the fact that the merger will reduce the number of nationwide wireless providers from 4 to 3. Relying on the outdated HHI metric, the Bureau notes that "market concentration would substantially exceed the threshold at which horizontal mergers raise competitive concerns."[113]

In the AT&T-Cingular and Sprint-Nextel merger reviews, however, the Commission conducted nearly identical concentration analyses to the AT&T/T-Mobile review, but came to the opposite conclusion regarding the mergers' likely competitive effects. From the start of its AT&T-Cingular analysis, the Commission notes the importance of other factors beyond concentration when determining whether a transaction may be anticompetitive, and points out that "[m]arket share data are the beginning, not the end, of the competitive analysis".[114] The FCC ultimately concluded that the reduction of nationwide wireless providers from six to five was not sufficient to raise anticompetitive concerns and instead noted that only when "the merger would reduce the number of competitors to two or fewer, a market with this degree of concentration presents a significant likelihood of successful unilateral effects and/or coordinated interaction even if the merged entity's market share is not especially high."[115]

---

[108] Id. at paragraph 101.

[109] Verizon / SpectrumCo Order, *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-12-95A1.pdf.

[110] Id. at paragraph 78.

[111] AT&T / T-Mobile Staff Analysis, *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DA-11-1955A2.pdf.

[112] Id. at paragraphs 48-84.

[113] Id.

[114] AT&T /Cingular Order at paragraph 96.

[115] Id. at paragraph 191.

Similarly, in Sprint-Nextel, the Commission finds the reduction of national wireless competitors from five to four "is not enough, by itself, to make a determination of the likelihood of anticompetitive effects with respect to this particular transaction."[116] And in discussing concentration, it "find[s] that competitive harm is unlikely in each CEA in which there will be four or more competitors present post-transaction."[117] Like in AT&T-Cingular, the FCC finds that only when reducing the number of competitors in a market to two or fewer will there be a likelihood of competitive harm.[118]

And yet despite those two merger reviews laying out seemingly clear standards for when a wireless merger would be considered likely to be anticompetitive, the FCC essentially quashed the AT&T/T-Mobile merger because it found a reduction to *three* national wireless providers to be *per se* anticompetitive. And it did so without identifying any changed conditions or structural shifts that would justify a different standard. Rather, the FCC simply moved the goal posts from those earlier mergers from two to three as the number of providers required to keep the industry competitive without any explanation at all.

In short, competition analysis at the FCC offers very little beyond structural presumptions, and, in so doing, significantly risks impairing, rather than furthering, the public interest.

B. Big is not Always Bad: The Consumer Welfare Standard

In merger analysis, antitrust law has moved away from structural presumptions based on HHIs, recognizing benefits to consumer welfare from economies of scale and vertical integration. It is time for the FCC to do the same.

The modern consumer welfare standard, which arose in antitrust law, demands a considerably more robust analysis, one that reflects the predictive limits of market structure on competitive effects and the complexities and dynamism of market behavior. The equation of concentration with harm to consumers is unsupported and misplaced, although claims to this effect remain widespread.

In the wireless arena, in fact, concentration of resources in the hands of the largest wireless providers has not slowed the growth of the market, nor has the wireless market seen higher prices or reduced quality or the other indicia of consumer harm: quite the opposite, in fact. The FCC's own data (drawn from the 16th Wireless Competition Report) show quite vividly that as concentration has increased, prices have decreased:[119]

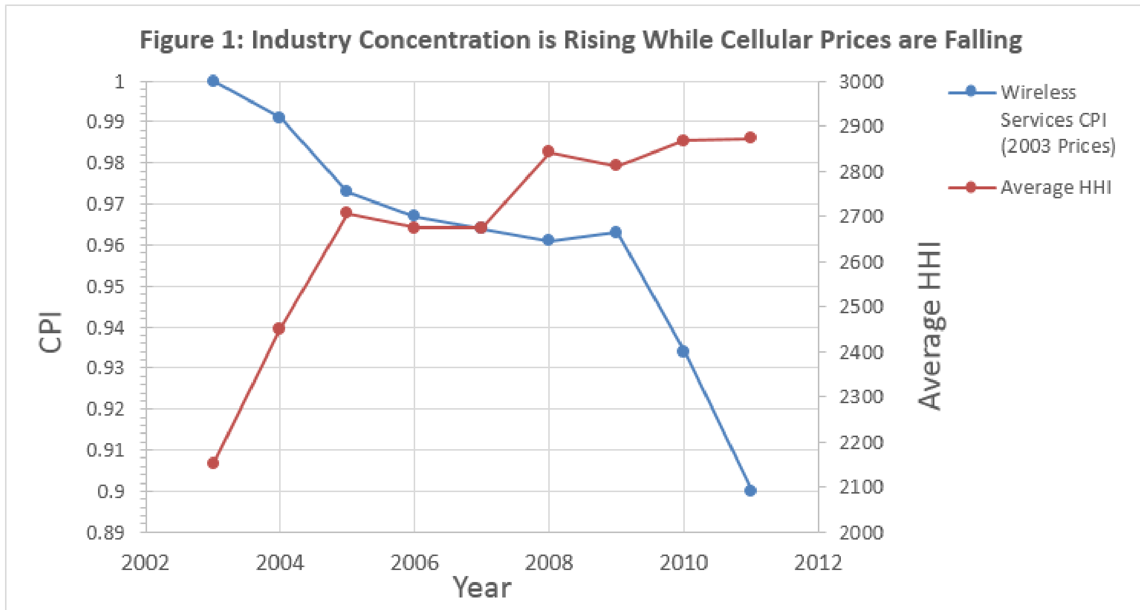
---

[116] Sprint / Nextel Order at paragraph 72.

[117] Id. at paragraph 119.

[118] Id.

[119] 16th Wireless Competition Report at Table 37.



Source: HHI from 16th Wireless Report Table 14; Wireless CPI from 16th Wireless Report Table 37.
Notes: Population-weighted average HHI of 172 Economic Areas as computed by the Commission. Cellular CPI is denominated in 2003 prices.

In the wireless industry, the presumed connection between concentration and harm is particularly difficult to defend. As a result of the competitive response to high demand, the current wireless market is characterized by "falling prices, accelerating output, technological dynamism, surging investment, ubiquitous advertising wars, and multidimensional competition," all of which are indicative of a highly competitive market.[120] Moreover, the market itself is shifting, and as "wireless" becomes increasingly synonymous with "broadband," this competition is continually expanding: where once the wireless market comprised essentially only cellular networks offering voice service and competing with each other and wire line phone service providers, the relevant competitors now include DSL, satellite, cable, Municipal Wi-Fi, and broadband over power line networks capable of transmitting *data* at high speeds.

Thus, while the Commission (and industry critics more broadly) seems to confine its analysis of proposed transactions to the familiar but outdated sectorial divisions that characterize its statute and its own organization, this is increasingly inappropriate. Rather, in assessing the effects of the proposed transaction, a more accurate — but less well quantified — assessment would also incorporate *wire-line* competitors offering data and phone services via cable and DSL — including some of the parties to this transaction.

Consumer behavior also strongly indicates the market is competitive. Consumers' ability to switch wireless providers at low cost in response to changes in price or quality encourages providers to vigorously compete to gain consumers. The term used to describe the percentage of current customers a

[120] Description of Transaction, Public Interest Showing and Related Demonstrations, Applications of AT&T Inc. & Deutsche Telekom AG, No. 11-65 (FCC Apr. 21, 2011).

service provider loses over a given time is the "churn rate." Recent trends have shown that churn rates have been increasing over the past few quarters, indicating the mobility of consumers. Although early termination fees tend to increase switching costs, all four nationwide carriers offer pro-rated early termination fee polices that lower the costs to consumers who transfer services. Consumers also have access to information through resources provided by wireless carriers and third parties[121] to aid them in making more informed decisions as to price, availability, quality, and features of mobile wireless services. And, at least since October 2010, costs associated with wireless number portability are "insignificant."[122] Easily accessible information and limited barriers indicate that there are low transaction costs in switching carriers.[123]

But this sort of dynamic is missed entirely by a concentration-focused review, and even a highly technical competition analysis of the sort offered in the leaked Staff Report assessing the AT&T-T-Mobile merger fails to capture these effects.

1. The FCC versus the Horizontal Merger Guidelines

The FCC's method of analysis can be contrasted with antitrust merger review as practiced in the courts and as outlined by the Horizontal Merger Guidelines. Modern economic analysis and agency policy alike espouse the superiority of assessing actual competitive effects over using crude proxies such as market concentration to infer whether a merger is procompetitive or anticompetitive.[124] The analytical shift has become so entrenched in agency practice that the DOJ and the Federal Trade Commission recently joined forces to update the Guidelines to reflect it. After conducting multiple workshops and reviewing comments from legal practitioners and members of the business community, the agencies released the revised Guidelines in 2010.

Ultimately, the inquiry enshrined in the Guidelines emphasizes a determination of the competitive effects and relies little, if at all, on inferences drawn from market structure. Instead, the agencies are to look at the ways in which a merger affects post-merger market participants' incentives to compete, including assessment of the likelihood of coordinated interaction between remaining market participants as well as unilateral action that could result in increased prices. Furthermore, according to the revised Guidelines, agency antitrust review should place greater emphasis on whether a merger creates efficiencies that permit the merged firm to reduce costs and thus lower prices and whether entry barriers are such that the presence of entrants will negate potential coordinated and unilateral effects post-merger.

Carl Shapiro, previously a DOJ Chief Economist and one of the intellectual architects of the 2010 Merger Guidelines, explained that the Merger Guidelines adopt an "effects-first" approach:

---

[121] Such as Consumer Reports, trade associations, marketing and consulting firms.

[122] Fifteenth Report at para 240.

[123] Id. at para 238-52.

[124] *See* Judd E. Stone & Joshua D. Wright, *The Sound of One Hand Clapping: The 2010 Merger Guidelines and the Challenge of Judicial Adoption*, 39 REV. INDUS. ORG. 145, 154 (2011).

> [T]he 2010 Guidelines place less weight on market shares and market concentration . . . [They] also follow a more integrated and less mechanistic approach…. The revised Guidelines emphasize that merger analysis ultimately is about competitive effects."[125]

The Guidelines downplay the significance of market shares and market concentration analysis, stating that "[t]he Agencies evaluate market shares and concentration *in conjunction with* other reasonably available and reliable evidence for the ultimate purpose of determining whether a merger may substantially lessen competition."[126] The assessment under the Guidelines is meant to be factual, with market shares only one data point in a complex analysis.[127] Moreover, at least since the FTC's successful challenge of the Staples-Office Depot merger, the agencies are increasingly aware that direct evidence of competitive effects is both available and more useful than drawing inferences from market structure.

So, heuristics like concentration metrics are, at most, ancillary to the ultimate determination of a merger review. But, perhaps inspired by its behind-the-scenes coordination with the FCC and contrary to the spirit of its own Guidelines, the DOJ's complaint to prevent consummation of the AT&T-T-Mobile transaction relied heavily upon market structure to make inferences about competitive effects, an analytical framework strikingly reminiscent of the outdated Supreme Court and Agency precedents of the 1960s.

It's worth quoting the FTC-DOJ Horizontal Merger Guidelines at some length here:

> *Highly Concentrated Markets*: Mergers resulting in highly concentrated markets that involve an increase in the HHI of between 100 points and 200 points potentially raise significant competitive concerns and often warrant scrutiny. Mergers resulting in highly concentrated markets that involve an increase in the HHI of more than 200 points will be presumed to be likely to enhance market power. The presumption may be rebutted by persuasive evidence showing that the merger is unlikely to enhance market power.
>
> The purpose of these thresholds is not to provide a rigid screen to separate competitively benign mergers from anticompetitive ones, although high levels of concentration do raise concerns. Rather, they provide one way to identify some mergers unlikely to raise competitive concerns and some others for which it is particularly important to examine whether other competitive factors confirm, reinforce, or counteract the potentially harmful effects of increased concentration. The higher the post-merger HHI and the increase in the HHI, the greater are the Agencies' potential competitive concerns and the

---

[125] Carl Shapiro, *The 2010 Horizontal Merger Guidelines: From Hedgehog to Fox in Forty Years*, 77 ANTITRUST L.J. 49, 55-56 (2010), *available at* http://www.justice.gov/atr/public/articles/263528.htm.

[126] Merger Guidelines, Sec. 5 (emphasis added).

[127] *See* Christine Varney, Assistant Attorney Gen., U.S. Dep't of Justice, An Update on the Review of the Horizontal Merger Guidelines (Jan. 26, 2010) (stating that "market definition should not be an end-all exercise" but "is something to be incorporated in a more integrated, fact-driven analysis directed at competitive effects" and that "this is not news").

> greater is the likelihood that the Agencies will request additional information to conduct their analysis.

Elsewhere the Guidelines are even more blunt:

> Market shares may not fully reflect the competitive significance of firms in the market or the impact of a merger. They are used in conjunction with other evidence of competitive effects.[128]

The language in the HMGs stating that "[m]ergers resulting in highly concentrated markets that involve an increase in the HHI of more than 200 points will be presumed to be *likely to enhance market power*" is nearly always rendered by commentators (and others who should know better) as "likely to be anticompetitive." But these simply are not the same thing. And it is certainly not the case that, *as a matter of law*, a merger with these HHI numbers is generally *presumed* to be anticompetitive.

Rather, as the DOJ itself states in the HMGs, such changes in concentration create rebuttable concerns about the extent of market power–leading not to any conclusions of law but rather and merely to the conclusion that it is "particularly important to examine whether other competitive factors confirm, reinforce, or counteract the potentially harmful effects of increased concentration."

These structural presumptions are bad economics, and they haven't been good economics–or even good law–for decades.[129] While the woeful structural economics and presumptions of illegality of the Supreme Court's *Philadelphia National Bank* decision still represent important precedent on the issue,[130] more recent lower court cases like *Waste Management*,[131] *Syufy*,[132] *Oracle,*[133] *Staples*[134] and *Arch Coal* [135] (among many others), as well as *General Dynamics* in the Supreme Court,[136] make clear that concentration simply isn't enough to establish consumer harm under Section 7.

This doesn't mean that the government can't make out a viable prima facie case based essentially on concentration measures, nor even that it couldn't ultimately prevail by successfully addressing other factors. But just because an agency *can* make a prima facie case doesn't mean it should.

---

[128] [Cite]

[129] See, e.g., http://truthonthemarket.com/2009/10/26/the-guidelines-should-be-revised-to-reject-the-pnb-structural-presumption/; http://truthonthemarket.com/2010/11/22/whats-an-internet-monopolist-a-reply-to-professor-wu/#more-9982; http://truthonthemarket.com/2009/10/27/fix-the-supply-side/; http://truthonthemarket.com/2011/12/02/a-quick-assessment-of-the-fccs-appalling-staff-report-on-the-att-merger/.

[130] CITE *Phila Nat'l Bank.*

[131] CITE

[132] CITE

[133] CITE

[134] CITE

[135] CITE

[136] CITE

2. *Burden of Proof*

One significant problem with the FCC's transaction review is that it operates under an inherently troubling process that, unlike traditional antitrust review, imposes on the parties to a transaction the burden to prove the merits of their deal. As we've noted, this turns the traditional antitrust approach – and judicial process more generally – on its head. Normally, the complaining party bears the burden of making its case; at the FCC, the implicit complainant (the FCC) may reject a transaction if the *parties* fail to demonstrate the benefits of their proposed deal.

Combined with the amorphous public interest standard and absence of rigorous constraints on the FCC's decision-making authority, in practice this means that the agency can reject a transaction for essentially any reason whatever: It is always possible to find some basis to claim that the parties have failed to prove the merits of their transaction.

This dynamic plays out most obviously in the role of traditional merger defenses in FCC transaction reviews. Under Supreme Court[137] and lower court precedent,[138] as we've discussed, concentration levels aren't enough to make out a winning challenge to a proposed merger; rather, today's approach is an effects-based approach, incorporating an assessment of entry, efficiencies, innovation, and a thorough analysis of coordinated and unilateral effects. In traditional merger review, these are raised as defenses to a prima facie case, with the transacting parties bearing the burden of persuasion, but with the ultimate burden of proof remaining with the DOJ (or FTC).

IV. LESSONS FROM THE FAILED AT&T / T-MOBILE MERGER

The FCC's Staff Analysis of the rejected AT&T / T-Mobile merger provides important lessons for the state of transaction reviews at the agency–and, as it happens, the DOJ, as well. The DOJ's decision to challenge the merger, bolstered by the FCC staff's objections to the deal, represents a significant, and disconcerting, milestone in telecom regulation. The size, significance and disposition of the merger further reinforce the significance of its rejection. But the real importance of this precedent lies in the method of the transaction's rejection, and the arguments mustered to defeat it. While the staff's analysis is more detailed and methodologically sound than the FCC's typical transaction review, it nevertheless rests ultimately on a structural presumption and incorporates several analytical decisions that undermine its reliability.

A. The FCC's Case Against the AT&T / T-Mobile Merger

While the DOJ actually rejected the transaction, it was the FCC, in a leaked staff report, that undertook the most detailed analysis of the deal. The FCC's report acknowledges that "there is more to establishing likely competitive harms than measuring market and spectrum concentration."[139] But it nevertheless bases

[137] General Dynamics

[138] See, e.g.,

[139] FCC Staff Analysis and Findings of AT&T / T-Mobile merger, *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DA-11-1955A2.pdf.

its conclusions significantly on the structural presumption; fails to identify a general standard of harm that *would* be sufficient to condemn the transaction; improperly defines the relevant competitors; ignores important market dynamics; and, in its own economic analysis, errs by enshrining concentration ratios in its model, thus importing a market share analysis into even its purportedly distinct competitive effects analysis.

Despite its lengthy technical analysis, the FCC makes clear at the outset the basis for its conclusion:

> The concentration levels and increases arising from AT&T's acquisition of T-Mobile are a strong indicator of harm to competition- and in antitrust trigger a presumption of such harm – for good reason. Market concentration statistics of the type generated by this transaction commonly indicate that buyers would have fewer viable choices, making both unilateral and coordinated competitive effects more likely. The more detailed analysis of the likely competitive effects arising from this transaction that we perform below confirms the story that these concentration indicators tell, and is consistent with the analysis that DOJ performed.[140]
>
> These data demonstrate high concentration and a substantial increase in subscriber and spectrum concentration in most individual CMA markets and nationally. In consequence, as the Commission has observed, under traditional structural analysis used to apply to the antitrust laws, AT&T's proposed acquisition of T-Mobile is presumed to create or enhance market power or facilitate its exercise, creating significant potential for competitive harm in most retail mobile wireless services markets, to the detriment of consumers.[141]

The substance of the analysis begins with market definition, which includes product and geographic markets. The FCC defines a general, "mobile wireless telecommunications services" product market.[142] This market includes voice and data services over a radio network, and it excludes fixed wireless and wireline services without discussion, simply neglecting to consider whether fixed broadband service might be in the same economically relevant market as mobile broadband.

The Complaint alleges as well that enterprise/government customers comprise a relevant submarket within the general market.[143] It claims that enterprise and government customers are different from individual consumers because they require carriers that can provide nationwide services; they demand features like pooled minutes, favorable upgrade policies, and favorable replacement policies; and the contracts are often individually negotiated.[144] Notably, the FCC fails to recognize that the distinction

---

[140] Staff Analysis at para. 19.

[141] Staff Analysis at ___.

[142] Staff Analysis at ___.

[143] Id.

[144] Id. at __. *But see* Geoffrey Manne, *A Couple of Quick Thoughts on the DOJ's Filing to Block AT&T/T-Mobile*, TRUTH ON THE MARKET (Aug. 31, 2011), http://truthonthemarket.com/2011/08/31/a-couple-of-quick-thoughts-on-

between channels of distribution is not economically meaningful; thus, they ignore the ease of supply-side re-branding,[145] the ease with which sales forces and prices can be shifted, and the reality that the spectrum constraint that affects all mobile networks (not the current distribution channel of spectrum access)[146] is the only meaningful constraint on the provision of mobile broadband service.

Geographically, the FCC effectively defines the market for mobile wireless telecommunications services as national, alleging that the nationwide effects of the proposed transaction must be considered because AT&T and T-Mobile's networks cover the vast majority of the U.S. population, the parties advertise nationally, and offer pricing, plans, and devices consistently on a nationwide basis."[147] It also argues that, because it finds anticompetitive effects across a "broad swathe of the nation," it need not assess the deal's effects in each local market in order to condemn the transaction.[148]

Furthermore, the FCC contends that the four largest mobile networks (AT&T, T-Mobile, Verizon, and Sprint) compete only with each other and only on a national level, and that their business decisions are not affected by smaller, regional competitors.[149] Regarding the enterprise/government submarket, the DOJ defines the geographic market nationally because enterprise and government employees are often nationally dispersed, requiring contracts that are national in scope.[150] In this way it asserts—incorrectly—that the relevant geographic market is determined, not by the areas in which customers live and make purchasing decisions, but by the areas in which the merging parties offer their service, even though sales in, say, Baltimore exert little or no competitive pressure on sales in, say, Los Angeles.

Having thus defined the market as national in scope and comprising only firms that have a national footprint, the FCC turns its attention to market structure. The thrust of the staff's allegations regarding market concentration is that the increased concentration following the merger would exceed the threshold levels set forth in the Guidelines, leading to a presumption that the merger would likely enhance market power. It uses HHIs to measure current and future market concentration as well as the change in concentration that would result from the merger.[151]

---

the-dojs-filing-to-block-attt-mobile/ (questioning the assertion that a sufficient number of business customers must purchase national calling plans to require a nationally defined market for enterprise customers).

[145] *See generally* U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines § 6.1 (discussing repositioning in the merger context); Amit Gandhi et al., *Post-Merger Product Repositioning*, 56 J. INDUS. ECON. 49 (2008) (same).

[146] *See* Thomas A. Lambert, *Four Lessons from the Whole Foods Case*, REGULATION, Spring 2008, at 22, 26-27 (discussing the inappropriateness of defining markets around distribution channels that do not significantly reduce transaction costs).

[147] Staff Analysis at ___.

[148] Id. at para. 34.

[149] Id.

[150] Id.

[151] Id..

The staff submitted with its analysis an appendix evaluating unilateral effects using an Upward Pricing Pressure analysis, consistent with the current Merger Guidelines.[152] The analysis primarily looks at Local Number Portability (LNP) data to derive estimates of post-merger diversion ratios and price effects. While the analysis is uncharacteristically rigorous in its methodology, it contains a number of questionable assumptions that undermine its conclusions. The same appendix also assesses the parties' claimed efficiencies, challenging the "engineering model" and the "economic model" upon which the parties' procompetitive claims were based.

The report also relies upon the fact that because the proposed transaction would reduce the number of service providers from four to three, there would be enhanced risk of coordination between competitors.[153] It claims that the markets are conducive to coordination because they include transparent, nationwide pricing, little buyer-side market power, and high barriers to entry."[154] In sum, however, the staff's coordinated effects analysis is quite cursory.

Finally, the staff's discussions of entry is fairly cursory. The FCC alleges that entry into both markets would be difficult, and would require entrants to establish national networks, possess scale economies with considerably more subscribers than they currently possess, and acquire strong brand recognition.[155] Essentially, the FCC claims that only a large, well-established competitor would be an efficient enough entrant to combat the harm it alleges would arise from the elimination of T-Mobile.

The analysis of efficiencies comprises the bulk of the report. And while its approach is seemingly empirically rigorous, it commits several errors. Moreover, the efficiencies analysis ultimately boils down to a determination that AT&T's claim that alternative solutions to its capacity problems would be "inferior" is insufficient to meet the public interest standard and the parties' burden of proof.[156]

B. Analysis of the FCC's Analysis

1. Market Share and Market Definition

---

[152] Staff Analysis, Appendix C.

[153] Id. Aside from the fact that the staff relies upon merely counting the number of firms present in the market to assess likely competitive effects, we disagree with its determination that there are only four competitors participating in the market. *See infra*.

[154] Staff Analysis at __.

[155] Id.

[156] Id.

Contrary to the Guidelines approach, the FCC analysis rests heavily upon both market definition and market concentration in relation to its discussions of competitive effects, entry, and efficiencies.[157] The discussions at times appear to be a strained effort to exclude relevant competitors from consideration. For example, the FCC explains that regional competitors are not within the defined market because they lack nationwide data networks, implying that their coverage is restricted to regional service areas and minimizing the presence of roaming agreements that allow those regional competitors to provide nationwide coverage. Meanwhile, this same analysis assumes away even marginal competition from providers with more limited coverage areas, even though less expensive, non-national service could well exert a competitive constraint among the large fraction of consumers who do not frequently travel outside their local coverage area.

As discussed above, the FCC ostensibly recognizes the weakness of reliance upon market structure as an indicator of market competitiveness, observing that highly concentrated markets may be intensely competitive given market factors including "entry conditions [and] degree of price and non-price rivalry."[158] While each local market comprises a different set of specific providers, varying by size, service offerings, coverage, and price, almost 90 percent of the U.S. population is covered by five or more service providers offering at least voice service,[159] and almost 68 percent is covered by four or more service providers offering mobile broadband.[160] At the outset, these data should give the FCC pause in inferring competitive effects from broad descriptions of the national market.

The DOJ, in assessing the status of broadband competition, has likewise concluded both that these markets are *likely* to be concentrated and that such concentration *does not raise* competitive concerns.[161] Rather, the DOJ cautioned the FCC against "striving for broadband markets that look like textbook markets of perfect competition, with many price-taking firms. That market structure is unsuitable for the provision of broadband services."[162]

At the same time, these competitive markets—like most network markets—will be characterized by complicated and varied pricing and usage schemes, in which the DOJ has stated previously that it does not expect robust competition to lead to "prices . . . equated with incremental costs. If they were, suppliers could not earn a normal, risk-adjusted rate of return on their investments in R&D and infrastructure."[163] Although commonly trotted out as a conclusion in support of monopolization, the fact that a market may be concentrated is simply not a reliable indicator of anticompetitive effects, and reliance on such conclusions is inconsistent with modern understandings of markets and competition.

---

[157] See the Merger Guidelines at para 5.3.

[158] Id. at para 40.

[159]Id. at paras 41-47.

[160] Id. And these numbers do not include the additional, important competition between mobile and wireline broadband.

[161] DOJ Submission at 7.

[162] Id. at 29.

[163] Id. at 7.

By defining a national market, limiting the relevant competitors to national carriers, and refusing to assess competitive effects locally the FCC ignores the competitive reality that, in many local markets (where retail purchasing decisions are made), various conditions including spectrum constraints, usage patterns, local regulations, product repositioning and ease of entry would likely ensure continued competition. At the same time, there is simply no justification for assessing the deal on the national market if a more localized analysis could have identified targeted, achievable divestitures that would have alleviated the agency's concerns. And to the extent that the deal could *improve* competitive conditions in the most populous markets and facilitate quality improvements in the least populous markets, the FCC's focus on national carriers and a national market misses the mark.

To the extent that the merger might harm consumers in some markets, but benefit consumers in others to a greater extent, a valid consumer welfare analysis would approve such a merger, despite its costs: If the deal would not come about without the full range of contemplated license transfers and if it benefits more consumers than it harms, it should be approved. It is precisely for this reason that the FCC's practice of imposing "voluntary" conditions on transactions is so potentially costly, as the FCC may be trading off some welfare-enhancing transactions for the ability to extract relatively trivial benefits in areas unrelated to the merger's actual competitive effects.[164]

Any market properly defined for the purposes of the proposed transaction should be geographically local and broad in product scope. The FCC has found that the relevant geographic markets are local, not national, and are based on cellular market areas (CMAs) and Component Economic Areas (CEAs).[165] This is because consumers search for mobile wireless providers in the areas where they "live, work, and travel."[166] Additionally, the markets should be defined locally because the transaction is expected to generate capacity and quality efficiencies that are local in nature.[167] Moreover, the DOJ, in advising the FCC on competition analysis in broadband markets, has noted that the proper market for analysis is local:

> Ultimately what matters for any given consumer is the set of broadband offerings available to that consumer, including their technical characteristics and the commercial terms and conditions on which they are offered. Competitive conditions vary considerably for consumers in different geographic locales.[168]

The DOJ goes on to conclude that "[b]roadband markets are local in nature as customers can choose only among providers that serve their neighborhoods, and the providers and service offerings differ from one

[164] See *supra* at ____.

[165] Cellco Partnership d/b/a Verizon Wireless, 23 FCC Rcd. 17,444, 17,472 (2008); Sprint Nextel Corp., 23 FCC Rcd. 17,570, 17,591 (2008).

[166] Fifteenth Report at para 50.

[167] Reply Declaration of Dennis W. Carlton, Allan L. Shampine & Hal S. Sider ¶ 64, Applications of AT&T Inc. and Deutsche Telekom AG, No. 11-65 (FCC June 9, 2011).

[168] *Ex Parte* Submission of the Department of Justice at 7, Economic Issues in Broadband Competition: A National Broadband Plan for Our Future, GN Docket No. 09-51 (2009).

area to another."[169] The FCC appears to have disregarded the DOJ's advice (which the DOJ itself disregarded in its own complaint in the merger case) regarding both the product and geographic markets, limiting its product definition to purely wireless markets and claiming that the geographic markets are not local but national.

But these definitions contradict the FCC's own previous definitions as well. The FCC's definition includes mobile telephony and broadband services.[170] The FCC has found that it is risky to define the mobile broadband service product market too narrowly because of the market's rapidly evolving nature.[171] Moreover, the proposed transaction was less about the mobile, or even mobile broadband, market than it was about the larger broadband market.[172] The full competitive effects of the merger should be evaluated in the broader context in which the combined firm's primary competitors are not only Verizon and Sprint but also behemoths like Time-Warner, Comcast, and Cox.

One reason for the poor performance of traditional analysis is that in dynamic markets, customers care less about the price level alone and more about the rate of change and performance in relation to price; in fact, firms may compete more on functionality than they do on price.[173] At the same time, the sources of competition are difficult to predict and potential competitors may be too readily excluded by an analysis that looks only at current, static market conditions. Rather than excluding a wide range of competitors from its analysis, the staff should have focused on "looking for potential innovative competitors and future races for dominance in a market"[174] wherever they might be.

2. *Competitive Effects*

a) Coordinated Effects

It is unlikely that a merger between AT&T and T-Mobile would have resulted in anticompetitive coordinated pricing in the mobile wireless telecommunications services market.[175] A coordinated effects analysis begins with understanding whether the market in question is vulnerable to collusion. While this analysis includes understanding market concentration levels, it is not so cramped an inquiry. Vulnerability to coordinated effects is not present in the mobile wireless telecommunications services market because of the heterogeneity of these services, which creates a complex market in which coordinated interaction is difficult.

Transparent and uniform pricing are factors that facilitate coordination. Heterogeneous pricing and business models, on the other hand, render it difficult to discern price information in the market. For example, some providers primarily offer contract plans, others offer non-contract plans, and still others

---

[169] *Id.* at 12.

[170] *Verizon Wireless*, 23 FCC Rcd. at 17,470; *Sprint Nextel*, 23 FCC Rcd. at 17,585.

[171] *Verizon Wireless*, 23 FCC Rcd. at 17,470; *Sprint Nextel*, 23 FCC Rcd. at 17,587.

[172] CITE to Manne & Szoka, Forbes piece on Susan Crawford.

[173] Connolly & Prieger at 404.

[174] Id.

[175] Again, we disagree with the DOJ's market definition but adopt it for the sake of argument.

offer something in between. Furthermore, providers offer plans that include various usage levels of data and/or voice service.[176] Service plans also vary significantly. Consumers choose from a wide range of plans that include various numbers of minutes, text messaging options, data services, and night and weekend calling.[177] Contrary to these facts, the FCC asserts that pricing in the market is transparent, although it does not explain how the competitors overcome the significant variance in service plans to determine their prices.

Geographic coverage ranges widely in scope as well.[178] Finally, but not least, rapid technological innovation and high consumer demand for new devices make competition a necessity for wireless service providers that wish to offer the newest and best products and plans.[179] Innovation is an important competitive factor because consumers often value quality of service more than price when choosing a service provider.

It is unlikely that the market would have become vulnerable to coordinated conduct if the proposed transaction were approved. Because of the ever-increasing capacity constraints and the high demand that wireless service providers face, in a post-merger market, AT&T would have the incentive to expand output because of the lower cost of doing so.[180] At the same time, other market participants would be facing different costs of expanding output and, therefore, different incentives to coordinate.[181]

Moreover, the fact that multiple firms would participate in the market post-merger makes future adverse coordinated effects implausible. Even if the geographic market really were national and included only Verizon, AT&T, Sprint, and T-Mobile, elimination of T-Mobile would leave Sprint in the market. Considering Sprint's past engagement in aggressive price-cutting[182] and its already competitive rates and customer service,[183] there is a significant potential for it to discipline prices post-merger.

When the geographic market is defined locally, as the FCC has elsewhere indicated is appropriate, the presence of multiple wireless providers indicates that coordinated effects are unlikely. If, for example, the large national providers were to coordinate post-merger, they would likely have less collective market power because of the presence of market participants with small market shares. Smaller market participants would have little stake in the outcome of coordinated interaction if they could rapidly expand their output in the relevant market.[184]

[176] Carlton et al. Decl. at 149.

[177] Id. at 150.

[178] Id. at 152.

[179] Id. at 151.

[180] Id. at 147.

[181] Id.

[182] Fifteenth Report at para 99.

[183] CITE Nusca.

[184] See Merger Guidelines, at para 7.2.

The makeup of the present markets exhibits this characteristic. Regional providers like C-Spire and Leap already compete for AT&T's customers.[185] Both have advertised the savings consumers can obtain by using their services versus subscribing to AT&T and Verizon.[186] Additionally, Leap was positioned to expand output through its roaming agreement with LightSquared.[187] The ability of these smaller providers to respond by expanding output makes it difficult even for participants that hold large shares of the market to sustain price increases resulting from coordinated conduct.

(1) T-Mobile as Maverick

One of the main focal points of the report is that the proposed transaction would eliminate T-Mobile's purported status as a maverick, permitting the remaining competitors to more easily coordinate, raise prices, and harm competition.[188] The report describes T-Mobile as an "aggressive competitor" and notes its position as the "value option" for wireless services.[189] The FCC claims that, prior to the merger proposal, T-Mobile had a competition plan that likely would have disrupted industry models and induced competitive responses from other market participants.[190] But the report does not explain (nor even mention) how T-Mobile could expand output to thus disrupt any coordinated output reductions by its competitors.

The FCC's own Wireless Competition Report from the year prior to its review of the transaction noted that T-Mobile has "[n]o U.S.-specific plans" for 4G deployment.[191] And T-Mobile in its filings in support of the merger notes that "[d]ue to spectrum exhaustion, difficulty in aggressive re-farming of existing spectrum holdings and a lack of other viable spectrum options, T-Mobile USA has no clear path to an effective, economical deployment of LTE."[192]

The Guidelines state that elimination of a maverick firm in a vulnerable market is likely to lead to coordinated effects,[193] The Guidelines (and other analyses) identify a maverick as a firm that exerts a particularly strong competitive constraint on other firms' ability to jointly control prices and/or output in a market. Thus maverick firms are those that "threaten to disrupt market conditions with a new technology or business model, . . . take the lead in price cutting[,] . . . resist increases in industry prices[, or] expand production rapidly using available capacity."[194] But on its own, the incentive or ability to price low is not

[185] See AT&T Description at 87, 90.

[186] Id. at 87.

[187] Carlton et al Decl. at paras 109, 120.

[188] Id.

[189] Id.

[190] Id.

[191] Fourteenth Wireless Competition Report.

[192] Declaration of Dr. Kim Kyllesbech Larsen, *In Re: Applications of AT&T Inc. and Deutsche Telekom AG for Consent to Assign or Transfer Control of License and Authorizations*, WT Docket No. 11-65, DA 11-799 (April 19, 2011) at 9, *available at* http://fjallfoss.fcc.gov/ecfs/document/view?id=7021240427.

[193] Merger Guidelines at para 7.1.

[194] Id. at para 2.1.5.

a sufficient condition to render a firm a maverick. Low prices may reflect not disruptive characteristics but instead product differentiation—lower quality or offsetting non-price characteristics, for example—that exerts no special disruptive pressure on a market. Thus, the *fact* of low prices is insufficient by itself to demonstrate that low prices have, in fact, had a "disruptive" effect on overall industry pricing or other characteristics.

While the FCC does adduce some evidence that T-Mobile's price-cutting was sometimes followed by similar cuts by AT&T and Verizon, as well as evidence of T-Mobile's creative pricing schemes and quality improvements, it does not convincingly distinguish between such conduct as simple aggressive competition or a desperate effort by T-Mobile to retain customers in the face of other conditions (most notably lower call and data quality) and the FCC's preferred market leadership explanation.

T-Mobile lacked (and may still lack) the financing and sufficient excess capacity necessary to deploy more spectrally efficient service, expand production and discipline prices.[195] In fact, T-Mobile is only now not struggling merely to retain subscribers.[196] These characteristics are inconsistent with those of a true antitrust maverick because a maverick "must steal market share from rivals by lowering price and increasing output."[197] Low prices alone do not make a maverick. Prices can differ for a variety of reasons, including quality of network. Despite its low prices, T-Mobile has been unable to increase output and market share.[198] Rather, it used lower prices as a mechanism for attracting and keeping customers in an attempt to remain merely relevant.[199]

If there are any mavericks in the market, it would almost certainly be MetroPCS or Leap. These companies have indeed transformed pricing in the market, leading the trend toward prepaid pricing—the only segment of the overall market that was growing at the time of the transaction. Meanwhile, T-Mobile, like all other providers, is working to catch up in this space and is itself facing great competitive pressure from these companies.

The FCC cites to the then-recent *H&R Block* decision[200] for its restatement of the structural presumption, but neglects to cite what may be that opinion's most interesting language, on what makes a disruptive competitor (of the sort T-Mobile is claimed to be). While the court in *H&R Block* did decide that TaxACT (the firm being purchased by H&R Block) was a disruptive competitor, it soundly rejected the sort of indeterminate arguments in support of its claims that the staff here uses to support its conclusion that T-Mobile plays this role.

The court in *H&R Block* notes that

[195] See Merger Guidelines, at para 2.1.5.

[196] See, e.g., http://www.nytimes.com/2013/08/09/technology/t-mobile-us-reports-largest-customer-growth-in-four-years.html?_r=0.

[197] Wright Testimony at 11.

[198] Id.

[199] CITE Nusca.

[200] CITE

> The government has not set out a clear standard, based on functional or economic considerations, to distinguish a maverick from any other aggressive competitor. At times, the government has emphasized TaxACT's low pricing as evidence of its maverick status, while, at other times, the government seems to suggest that almost any competitive activity on TaxACT's part is a "disruptive" indicator of a maverick.

The staff here engages in a similar enterprise, failing to root its claims in any clear standard, other than by noting that T-Mobile seems to offer lower (and creative) prices. But the FCC neglects to note that the very pricing "innovations" it cites to support the claims also indicate various quality reductions (unlimited data plans, but with reduced speeds, for example), and the staff itself notes that T-Mobile engaged in product differentiation–possibly a helpful competitive strategy, but not one consistent with being a maverick, which would require competition *within* the same markets as competitors, rather than the creation of a competitively distinct one.

For this and other reasons, coordinated price effects are unlikely. First, efficiencies "may make coordination less likely or effective by enhancing the incentive of a maverick to lower price . . . ."[201] Sprint, as well as small, regional providers, would still be present post-merger and would likely still further competition (even though the staff excludes this effect from its analysis by excluding most of these competitors from its relevant market). Because these numerous market participants vary in size and product offerings, they face different competitive incentives and are unlikely to participate in coordinated conduct post-merger. In fact, they would probably seize the opportunity during a coordinated price increase to lower their own prices and steal customers away from their competitors. Some of them, such as Leap and Clearwire, have the ability to employ excess spectrum and can easily increase their output in that situation in order to increase their own market shares and profits.

This also again points up the error in excluding smaller, regional providers from the relevant market analysis. The FCC's claim that MetroPCS, Leap and other providers are not competitors to the "national" carriers is in contravention of actual market dynamics. That "none of these providers' networks cover [sic] more than 34 percent of the U.S. population"[202] is immaterial; subscribers purchase and, primarily, use their mobile phones in local service areas. Because all mobile and wireline phone services are interconnected, it hardly matters whether their chosen carrier also offers service in other parts of the country.

b) Unilateral Effects

The closer the products of merging firms are to each other as substitutes, the more direct is the competition between the products.[203] When two merging firms sell products that are especially close substitutes, the merger raises the possibility that the post-merger firm will have the incentive to increase price that did not exist before the merger. In such cases, this new incentive to increase price is attributable

---

[201] Merger Guidelines at para 10.

[202] FCC Staff Analysis at para 38.

[203] Merger Guidelines at para 6.1.

to the fact that, after the merger, the firm will recapture some of the sales lost from a price increase on one of the products as customers substitute toward the second product. Put another way, the logic of a unilateral price effect is that the "cost" of a post-merger price increase may fall because some of the lost sales associated with the price increase are recaptured by the firm in the form of new sales by its merging partner. The Guidelines recognize the economic logic of this possibility. To evaluate the potential for unilateral price effects, it is thus important to understand the relative location of the merging firms' offerings in "product space," and in particular, whether (and to what extent) consumers consider the merging firms' products as next best alternatives.[204]

Although the FCC reached a different conclusion, other analysis of consumer preferences for wireless service providers suggests that AT&T and T-Mobile products are not perceived as especially close substitutes.[205] There are important differences between the products and their customers that shed significant doubt over the FCC's claims that, in the face of a price increase from one of the products, marginal consumers would be most likely to shift to the other product. For instance, AT&T's customers use data more heavily than T-Mobile's customers.[206] The two providers also cater to different demographic groups: AT&T attracts more contract subscribers and business entities, while T-Mobile attracts non-contract, non-business, and value-conscious subscribers.[207]

Furthermore, other already-existing participants in the market can offer closer substitutes to each of the merging firms' products, rendering post-merger unilateral price increases unlikely.[208] Further, non-merging firms are able to reposition their products in competition with the merged firm's products, which can sufficiently offset any potential for anticompetitive unilateral effects.[209] Unfortunately, the FCC dismissed product repositioning by regional competitors by claiming that they could not replicate AT&T's nationwide reach. But as noted above, this assertion is a red herring.

In actuality, for T-Mobile in particular, the next closest substitutes are more likely to be those offered by Sprint, MetroPCS, and Leap, who also cater to value-conscious subscribers.[210] Therefore, a price increase on AT&T products or services would probably lead its customers to divert first and foremost to Verizon, not T-Mobile. Similarly, an increase in T-Mobile's pricing would lead its value-conscious subscribers to seek low-priced products and service plans from providers like Sprint, MetroPCS, and Leap.

The potential for unilateral effects is often analyzed in merger analysis with an index used to measure the intensity of Upward Pricing Pressure (UPP) created by a merger between the producers of two close substitutes. While UPP can be very useful as a screen for identifying mergers with the potential for unilateral price effects, it is not designed as a substitute for a comprehensive analysis of competitive

---

[204] Id.

[205] See Carlton et al. Decl., at para 88.

[206] See id. at para 145.

[207] See id.

[208] Merger Guidelines, at para 6.1.

[209] Id.

[210] See id.

effects.[211] This is especially so when there is a dearth of sufficient data to accurately predict potential UPP.[212] Under those conditions, estimating UPP requires multiple (and restrictive) assumptions.[213]

The FCC's unilateral effects analysis estimates values for necessary parameters (industry margins, diversion ratios, and the percentage of customers that would drop wireless service altogether rather than switch from AT&T to T-Mobile and vice versa) that are too speculative to produce reliable results.[214]

The FCC uses two measures to assess diversion ratios for the proposed merger: proportional diversion ratios based on wireless market shares, and LNP data, relying primarily on the latter.

It is important to note (not that this is why the FCC rejects market shares as the more reliable measure) a typically overlooked, fatal problem with market share proportions for this purpose. Notice that an assumption of diversion ratios based upon market shares requires the underlying assumption that the analysts have correctly identified a market definition. In this case, the UPP is calculated by assuming that marginal customer switching behavior in response to an AT&T price increase will follow national market shares. This approach assumes out of the analysis important regional players such as MetroPCS, Leap, and Cellular South. Obviously, if some consumers would switch to those rivals in response to a price increase, then diversion ratios, and the likelihood of a unilateral price increase, would fall accordingly.

Most fundamentally, the *very purpose* of substituting away from market definition toward direct measures of competitive effects such as UPP analysis in the new Merger Guidelines is that market definition was notoriously unreliable as a predictor of market performance.[215] In other words, the UPP approach was meant to avoid market definition and reliance upon market structure to make inferences about competitive effects; executed with appropriate data, UPP analysis retains that potential. Here, where UPP analysis bootstraps upon an assumed market definition imposed by the analyst, it does not appear to offer a methodological improvement over the older and disfavored structural presumptions. In other words, the UPP analysis based upon market share proportions simply repeats and compounds the defects that condemn the structural presumption in the first place.

As noted, however, the FCC, in its UPP analysis, adopts a different metric to estimate diversion ratios: LNP data. Here, the FCC looks at how many customers switch from AT&T to T-Mobile (and other providers) based on porting of their existing numbers. While this metric seems to avoid the market share diversion ratio pitfall, it actually suffers from several significant defects.

First, as the FCC itself points out, because customers who port their numbers may not do so in response to price or quality changes, the number porting data may not be a good proxy for diversion ratios based on

---

[211] Serge Moresi, The Use of Upward Price Pressure Indices in Merger Analysis, Antitrust Source, February 2010, at 1, 6.

[212] See Carlton et al. Reply Decl., at para 66.

[213] Id.

[214] Carlton et al. Reply Decl., at para 66.

[215] *See* Shapiro at 66..

price or quality changes.[216] Moreover, because some portion of customers switch providers without porting their numbers, data derived only from those who do port their numbers may be systematically biased.[217] Finally, there is no evidence in the FCC's report that it considered number porting patterns over time, nor that it considered how long ported numbers remained with a new carrier. But it is quite possible that T-Mobile's very dissimilarity from AT&T explains the frequency of number porting between the two. On the one hand, subscribers moving from AT&T may have moved in order to take advantage of T-Mobile's more robust pre-paid offerings, in some case for a short duration before moving again to another carrier. Meanwhile, there is no evidence that the FCC considered other factors that might affect number porting decisions. Verizon, for example, has historically erected more barriers to number porting than other carriers. It is quite possible that these barriers impeded number porting (but not necessarily diversion from AT&T or T-Mobile to Verizon without porting), or that customers "parked" their numbers for short periods of time with the relatively cheaper (and lower quality) T-Mobile before moving more permanently to another carrier.

Finally, because AT&T and T-Mobile use GSM technology, while Verizon uses CDMA, it is more likely that a customer's existing handset would be functional in a switch between AT&T and T-Mobile than between either of those carriers and Verizon. But, again, this is likely a short-term effect, as handset compatibility might pose no impediment to switching when a customer upgrades, and many number ports from AT&T to T-Mobile and vice versa may have been temporary until customers were ready to purchase new handsets.

One other point is worth noting. In an effort to check the robustness of its diversion estimates, the FCC staff report attempts to correlate number porting data with price changes and new phone introductions by T-Mobile, AT&T and other potential competitors. In the former case, the staff finds that customers seem to move more frequently from AT&T to T-Mobile in response to price reductions at T-Mobile than from AT&T to MetroPCS in response to price reductions there. But the data used by the staff are problematic.

In particular, while MetroPCS and T-Mobile alike may be competitors to AT&T, there may have been significant enough differences among the three that, while the specific price decrease instituted by T-Mobile attracted a significant number of AT&T customers, the MetroPCS price decrease did not. Without more, however, this does not necessarily indicate, as the FCC staff claims, that "it appears that AT&T subscribers view T-Mobile to be a closer substitute than MetroPCS."[218] The staff's conclusion is further undermined by its own analysis claiming significant switching among T-Mobile and smaller low-cost providers (like MetroPCS) as well as Sprint. While these data are also unreliable for reasons discussed above, to the extent that they show high cross-elasticity between T-Mobile and low-cost carriers, as well as between AT&T and T-Mobile, it is difficult to maintain in the face of LNP data and high churn rates that AT&T and smaller low-cost carriers are not similarly substitutes for each other.

---

[216] Staff Analysis at para. 10.

[217] Id.

[218] Id. at para 26.

With respect to the data derived from switching in response to new handset introductions by AT&T (in this case new iPhone models), it is somewhat remarkable that the staff views this as evidence that AT&T and T-Mobile are close substitutes, without similarly recognizing the importance of factors like device offerings in confounding its simplistic analysis. It is likely that many customers switch carriers (or decide not to switch carriers) precisely in order to get new devices that may not be widely available. If this is true, then price competition between carriers may be dampened and post-merger incentives to raise prices may not be as significant as the FCC's models predict.

Even accepting the UPP calculation on its face, it is critical to keep in mind that such calculations are designed as an initial screen to evaluate mergers worthy of further scrutiny. That further scrutiny considers factors such as efficiencies, repositioning, and entry that create downward pricing pressure.[219] The merger allows the parties to relax capacity constraints and satisfy high and ever-increasing consumer demand for not only new and innovative product and service offerings but also improvements in the functioning of current network services. AT&T is under significant pressure to increase the quality of its services as well as its output in order to continue competing effectively for wireless service subscribers with Verizon (it must be pointed out that, under certain conditions, we can expect competitive outcomes from markets with even a *single* competitor, a fact that also further undermines the structural presumption). Consummation of the transaction would allow it to do so.[220] Its incentive to make use of the capacity it gains makes it very unlikely that AT&T will withhold additional output—and in fact it has incentives to make more efficient use of existing capacity; thus, it would be unable to increase prices. Instead, it would merely be able to keep up with competition in the dynamic wireless market.

3. Entry

Although the mobile wireless industry is marked by high fixed costs, the FCC has identified important market conditions that facilitate entry. Access to spectrum is not limited to Commission auctions.[221] Potential entrants can also purchase or lease spectrum on the secondary market.[222] Additionally, roaming agreements make it possible for an entrant to provide nationwide coverage without needing to spend the capital necessary to build out an entire network upfront.[223]

In this regard it is important to note that allegedly regional providers like MetroPCS and Leap—providers that are effectively excluded from market analyses like the FCC's that rely too heavily on casual inference from concentration ratios—can and do enter into agreements with each other (as well as the larger providers) to offer reciprocal roaming, in effect creating for themselves national coverage without needing to purchase more geographically diverse spectrum.[224]

---

[219] *See* Moresi at 6.

[220] Carlton et al. Decl. at 139.

[221] Fifteenth Report at para 62.

[222] Id.

[223] Id. at para 63.

[224] *See* Press Release, MetroPCS, Leap Wireless International, Inc. and MetroPCS Communications, Inc. Enter into National Roaming Agreement and Spectrum Exchange Agreement and Settle Litigation (Sept. 29, 2008), *available*

The Fifteenth Report emphasizes the importance of recent entry of current facilities-based providers, such as Leap and MetroPCS, into new geographic markets.[225] Leap has made it its mission to engineer networks that are both efficient and of high quality in order to sell its services to customers for less than it costs other providers to produce them.[226] MetroPCS has recently entered into major metropolitan areas throughout the United States.[227] Even companies like Cox Communications are entering the mobile wireless industry, planning to bundle those services with the services they already provide.[228] Furthermore, providers like LightSquared and Clearwire currently hold unused spectrum, which gives them "the ability to 'leapfrog' existing carriers by deploying the most current technology."[229] Clearwire, which the Commission attributes to Sprint because of Sprint's 10 percent equity interest and a common member of both companies' boards of directors,[230] has the ability to expand output without needing to overcome the entry barrier of obtaining access to spectrum. The Fifteenth Report also summarizes other entry commitments, including Atlantic Tele-Network, which is large enough to introduce new competitive constraints upon incumbents.[231]

While it certainly remains true that spectrum is scarce and remains an impediment to immediate, nationwide, greenfield entry, the increasing scope of smaller competitors, along with competition from non-mobile entrants unencumbered by spectrum scarcity, point to further important avenues for entry neglected by the staff's analysis.

4. Summing Up

While the FCC's staff report on the AT&T / T-Mobile merger is infinitely more rigorous than the Commission's typical competition assessment, it still falls flat in significant and fatal respects. The agency simply cannot escape its structural presumption. It operates under a set of procedures that weight heavily against transacting parties who are required to make an affirmative case for the benefits of their transaction, and the Commission can block a proposed transaction simply by identifying mechanical

---

at
http://investor.metropcs.com/External.File?t=2&item=g7rqBLVLuv81UAmrh20Mpyn7W9izoar+eEnO+XVZKon4O7IvQhLgT4Duq3vvQcpj8SnoTo2R+xYtvBv97Uo4EA==.

[225] Fifteenth Report at para 69.

[226] Id.

[227] Id.

[228] Id. at para 72.

[229] Carlton et al. Decl. at para 120.

[230] Fifteenth Report at para 68. Nevertheless Clearwire adamantly defends its independence and, unlike the FCC, does not consider itself a part of Sprint. *See* Comments of Clearwire Corp. at 4, Applications of AT&T Inc. and Deutsche Telekom AG, No. 11-65 (FCC May 31, 2011), *available at* http://fjallfoss.fcc.gov/ecfs/document/view?id=7021681272 ("To be accurate, Clearwire is an independent company with operations and customers entirely separate from Sprint and which in the last year has increasingly distinguished itself as a wholesale provider.").

[231] Fifteenth Report at paras 71-72.

defects in the transacting parties' case. Most important, the FCC's analysis here is still insensitive to complex and subtle market dynamics that undermine its conclusions, even though the Staff Analysis is considerably less blunt than the typical concentration analysis employed by the FCC. While in this case (if the DOJ's Complaint is any evidence) the antitrust authorities would not have performed any better, at least a review by the DOJ alone (as opposed to the typical dual review by both the DOJ and the FCC, or review by the FCC alone) would have been subject to immediate and real judicial scrutiny, with the burden of proof falling on the government, rather than the transacting parties.

V. CONCLUDING THOUGHTS — SUGGESTIONS FOR REFORM

A. The FCC Should Employ a Rule of Reason Analysis and Only Consider Consumer Welfare Effects of License Transfers in the Screen

While minor tweaks to the spectrum screen and HHI analysis will improve the process of analyzing spectrum holdings, the FCC would be better served by eliminating the spectrum screen and starting from scratch. Particularly in a dynamic, innovative industry like wireless, the FCC's approach represents a costly adherence to outdated, static competition analysis. As former Assistant Attorney General Tom Barnett has stressed:

> While static efficiency is important, the greater share of welfare gains — sometimes the much greater share — comes from technical change and the forces of dynamic efficiency. . . . [A]ntitrust enforcers must be careful not to pursue immediate, static efficiency gains at the expense of long-term, dynamic efficiency improvements, since the latter are likely to create more consumer welfare than the former. Accordingly, U.S. enforcers approach practices that bear on innovation incentives with something close to the medical principle of 'first, do no harm.'[232]

There is no reliable evidence that a carrier's control of more than a third of the usable spectrum in a market has, *ipso facto*, the power to harm consumers—and still less evidence that prohibiting spectrum transfers that exceed this threshold serves "the forces of dynamic efficiency." Using HHIs and this arbitrary threshold doesn't further what should be the FCC's overriding objective: ensuring the availability of sufficient spectrum, and the investment necessary to deploy it, to meet consumer demand. Instead of treating market concentration as the basis for rejecting a transaction, we need an analysis of why a proposed transaction would actually make consumers worse off—the lodestar of antitrust law. In other words, the FCC should replace its *de facto per se* rule with a rule of reason standard grounded in consumer welfare. While the FCC already purports to conduct a similar type of analysis in markets where the spectrum screen is triggered, that analysis in practice, as noted above, is still based on an evaluation of concentration in wireless markets; it is merely a more detailed version of the screen.

[232] Thomas Barnett, Presentation to the George Mason University Law Review, "Maximizing Welfare Through Technological Innovation" (31 October 2007), *available at* http://www.usdoj.gov/atr/public/speeches/227291.htm.

Instead, the FCC should abandon its focus on the percentage of spectrum held by a company and replace it with an analytical framework that (a) evaluates how increased spectrum holdings actually affect consumers and (b) accurately weighs those likely effects against any efficiencies or procompetitive justifications supporting a transfer. Competition from other wireless providers is certainly part of the analysis, but there are a number of other factors that should be considered including, among other things, the long-term capacity and investment incentives of market players, the quality of ancillary services to the provision of voice and data transfer, how and when spectrum would be deployed with and without a transfer, how efficiently it would be used with and without a transfer, and whether its deployment is better supported by the requisite technological, physical and organizational apparatus to deliver quality service to consumers before or after a transfer.

Perhaps most importantly, this competitive analysis simply can't generate reliable conclusions if spectrum is analyzed independently from broader competitive conditions. Thus, a proper competitive analysis would also include assessment of competition from imperfect substitutes (*e.g.*, fixed wireless and fixed terrestrial broadband), technological developments that may or will alter spectrum efficiency and entry, product (and quality) differentiation among competitors, historical price and quality changes in the market, the likelihood of coordinated effects, the presence of buyer power, constraints arising from other layers of the network (*e.g.*, device makers and content providers), the presence and extent of switching costs, and possible intellectual property-based constraints on competition — among others.

Perhaps the most important factor to consider in such an analysis is the benefit to consumers from *expanded* rather than contracted network holdings. The ability of a wireless provider to meet its customers' future data demands (and to deploy the resources necessary to capitalize on spectrum holdings sufficient to do so) is crucial to a sensible analysis, and yet it plays little or no role in the current system. With a spectrum crunch on the horizon, it is essential that sustained viability and capacity in the face of rapidly expanding demand becomes the focus of FCC transaction analysis. Consumers should not suffer from inferior service—today or tomorrow—just because a transaction might increase concentration on paper.

B. The Burden of Proof Should Fall on the Reviewing Agency, not the Parties to a Proposed Transaction

[Incomplete] In the antitrust cases it brings the DOJ bears the burden of showing harm, measured against extensive case law and economic analysis. Parties before the FCC, on the other hand, bear the burden of demonstrating that their transactions enhance competition and serve the "public interest." That phrase "lacks any definite meaning," as Ronald Coase noted more than 50 years ago.[233]

The concern is that, as industry evolves and competitors vie for scarce resources (especially in wireless broadband), they meet new competitive challenges with novel business arrangements and increased investment. Economies of scale may become more important, and concentration may increase, benefiting, rather than harming, consumers. But the FCC seems willing (and able) to act beyond its authority to

[233] CITE Coase.

condemn these actions as anticompetitive or against the public interest, without actually having to prove it.

C. The FCC Should not Impose Conditions Unrelated to Demonstrated Consumer Harms

[Incomplete] Congress should rein in the FCC. The FCC Process Reform Act passed by the House in the 112th Congress is a good start, requiring that conditions be narrowly tailored to real harms the FCC actually has authority to regulate:

> (1) IN GENERAL- The Commission shall condition its approval of a transfer of lines, a transfer of licenses, or any other transaction under section 214, 309, or 310 or any other provision of this Act only if--
>
> (A) the imposed condition is narrowly tailored to remedy a harm that arises as a direct result of the specific transfer or specific transaction that this Act empowers the Commission to review; and
>
> (B) the Commission could impose a similar requirement under the authority of a specific provision of law other than a provision empowering the Commission to review a transfer of lines, a transfer of licenses, or other transaction.
>
> (2) EXCLUSIONS- In reviewing a transfer of lines, a transfer of licenses, or any other transaction under section 214, 309, or 310 or any other provision of this Act, the Commission may not consider a voluntary commitment of a party to such transfer or transaction unless the Commission could adopt that voluntary commitment as a condition under paragraph (1).[234]

D. Congress Should Abolish Duplicative Merger Reviews

We have noted elsewhere that this sort of competition analysis is the proper province of the expert antitrust agencies, not the FCC.[235] We continue to have qualms about competition review at the FCC. And when, as in the case of a telecom merger notified under Hart-Scott-Rodino to the antitrust agencies, the DOJ or FTC engages in a competition analysis, we continue to maintain that the FCC's review should focus narrowly on telecom-specific issues (*e.g.*, compliance with FCC rules and fitness to hold a license) and the FCC should act to advise and inform the antitrust agency's determination; its own competition review should not have dispositive effect.

---

[234] FCC Process Reform Act, *available at* http://hdl.loc.gov/loc.uscongress/legislation.112hr3309.

[235] *See* Comments of Geoffrey A. Manne & Berin Szoka, *In re Application Of Cellco Partnership d/b/a Verizon Wireless and SpectrumCo LLC for Consent to Assign Licenses & Application Of Cellco Partnership d/b/a Verizon Wireless and Cox TMI Wireless, LLC for Consent to Assign Licenses*, WT Docket No. 12-4 (2012), *available at* http://techfreedom.org/sites/default/files/VZ_SpectrumCo_filing_0.pdf.

But when, as in the case of a simple spectrum license transfer that does not meet HSR notification thresholds nor merit review by the FTC or DOJ, the FCC is the sole arbiter of a transaction's regulatory approval, it must engage in meaningful, rigorous review. It is a losing proposition to substitute the easy administrability and economic inaccuracy of spectrum concentration analysis for the complexity and economic rigor of a thorough competition review. Moreover, as the antitrust agencies and courts develop expertise, guidelines and doctrine in analyzing mergers and corporate acquisitions involving spectrum, the FCC — properly guided by the same standards and principles — will be able to draw on this body of law and economics to inform its own reviews of spectrum transfers arising outside of mergers.

There is nothing about telecommunications generally nor spectrum in particular that demands the development of a *sui generis* body of spectrum competition law. Although necessitating technical expertise to evaluate evidence and its implications, the analysis of the competitive consequences of spectrum transactions is a subset of antitrust law, and it should be applied as such by the FCC.

E. A Revamped Case-by-Case Analysis Is Necessary

Rather than limiting concentration in the wireless market based on the outdated equation of market power with consumer harm, the Commission ought to enable companies to meet consumers' clamoring for more spectrum—because this is a better means of serving what should be the ultimate goal of competition policy: promoting consumer welfare. The FCC's process for evaluating spectrum holdings should reflect that shift. The process should strike a balance between getting spectrum into the market for the needs of consumers and protecting consumers from anticompetitive behavior by companies. To do so, the FCC should follow the lead of antitrust law, which has largely abandoned per se prohibitions in favor of empirically meaningful, economically driven merger analysis and other "rules of reason" that incorporate dynamic efficiency concerns far better than do more static, structural presumptions. A return to the *per se* (or "bright-line limit") approach to spectrum holding analysis that the Commission abandoned in 2003 makes no sense in today's competitive wireless market.

As Commissioner McDowell noted in his Statement accompanying the agency's Spectrum Holdings NPRM, the Commission eliminated the hard cap "after determining that spectrum aggregation limits were no longer necessary due to meaningful competition among providers of telecommunications services."[236] The impressive growth in not only the size of the wireless market over the last nine years but also its quality, affordability and geographic reach—to say nothing of the enormous amount of investment by alleged monopolists in these markets—is powerful evidence of robust competition. A hard cap on spectrum holdings would needlessly allow for zero balancing of the procompetitive, consumers benefits that future transactions could provide.

Customers of the nation's two largest wireless companies, Verizon and AT&T (that is, most of us) would suffer greatly under a hard cap, as the cap would likely result in preventing these companies from adding spectrum to improve their service to meet current—let alone future—demand. A majority of wireless customers in America would face diminished service under such a rule. The Commission should instead

[236] Statement of Commissioner McDowell, In the Matter of Policies Regarding Mobile Spectrum Holdings, WT Docket No. 12-269, Before the Federal Communications Commission.

retain a case-by-case process for reviewing spectrum acquisitions to be able to adjust for the nuances of each particular transaction; the spectrum screen simply is not the proper vehicle for a pro-consumer case-by-case analysis.