THE CAPITOL FORUM

Vol. 7 No. 5 January 10, 2019

T-Mobile/Sprint: California, New York Antitrust Enforcers Skeptical About Efficiencies Arguments; DOJ Plans Depositions of Cable Providers

Deal Update

T-Mobile (TMUS) and Sprint (S) are confronting federal and state antitrust enforcers' skepticism about their proposed $26.5 billion merger, sources familiar with the matter said.

The attorney general's offices of California and New York are peppering the wireless carriers with questions about their efficiencies arguments, asking for more evidence and data to back up those justifications for the deal, the sources said. DOJ staff, meanwhile, has discussed with several cable providers plans to depose their executives as part of the department's review of the transaction, some of the sources said.

In the past 30 days, DOJ staff and state enforcers increasingly have coordinated their T-Mobile/Sprint reviews, the sources said.

The actions of DOJ staff and the two states' antitrust enforcers are a setback for T-Mobile and Sprint. The companies are mostly pinning their hopes for the deal's clearance on winning over regulators with their efficiencies argument—that by combining, they could more effectively and quickly create a robust 5G wireless network than either carrier could do alone.

DOJ staff's plans to depose the cable providers also could be an ominous sign. Staff regularly deposes merging parties' executives in big cases and is doing so as part of the department's T-Mobile/Sprint review. But third-party depositions often indicate the staff is sympathetic to concerns raised in the depositions and could use them to support a recommendation to challenge a merger.

In this case, some cable providers have complained that the deal would combine the nation's top two wireless wholesalers, leading to higher prices for mobile virtual network operators (MVNOs). MVNOs, which include some cable providers, buy access to the four national wireless carriers' networks at wholesale rates and re-sell voice and data services to customers under their own brands.

DOJ staff might also use the depositions as an opportunity to find out more about the competitive impact of cable providers entering the wireless market.

Shutdown impact. Beyond enforcers' questions, T-Mobile and Sprint are contending with the partial government shutdown's impact on the merger review. The Federal Communications Commission last week was forced to suspend operations, including the agency's review of the transaction.

The shutdown's impact on DOJ's review is less certain. While declining to discuss the review, DOJ spokesperson Wyn Hornbuckle said most antitrust division employees won't continue to work after the division's funding runs out. Under DOJ's shutdown guidelines, the department could continue to fully staff the review if it considers it critical to do so.

State and federal enforcers are still open to persuasion, giving T-Mobile and Sprint a chance to flesh out their arguments with more data and analysis. The companies have responded with voluminous documents, economic models and data to support their claim that through the merger they can double their network capacity at roughly half of what it would cost if they remained separate.

T-Mobile and Sprint's answers in the coming days could prove critical as senior officials at the federal and state enforcement agencies turn their attention to evaluating the deal's pluses and minuses. These decision-makers, namely FCC Chairman Ajit Pai and DOJ antitrust chief Makan Delrahim, could ultimately overrule any staff objections.

DOJ's Hornbuckle declined to comment on the planned cable-provider depositions. Spokespeople for T-Mobile and Sprint didn't immediately respond to requests for comment. Spokespeople for the attorney general offices of New York and California declined to comment, citing their ongoing investigations.

California, New York impact. The merger's impact on California and New York is important because the New York City and Los Angeles regions are the first and second-largest wireless user areas in the country, respectively. T-Mobile and Sprint have deep roots and extensive networks in both states. T-Mobile in 2002 first launched its U.S. wireless service in California and Nevada.

The states are central to the companies' 5G plans. Last year, T-Mobile pledged to begin building a 5G network in 30 cities, including New York and Los Angeles. Sprint initially plans to roll out its 5G network in nine metropolitan areas, including those two cities.

The companies and their prepaid brands are popular with subscribers of color, according to an analysis by deal opponent Free Press—a key consideration in California and New York, which are home to sizable Hispanic and African American communities. Free Press, a consumer watchdog group, estimates that 56 percent of T-Mobile's customers are people of color while 45 percent of Sprint's users are.

Both companies have a significant presence in California and New York cities and spottier service in the states' rural sections—a coverage pattern the companies roughly follow across the country. T-Mobile courts subscribers with its traditional post-paid service while targeting low-income residents with its MetroPCS prepaid brand. Sprint targets low-income smartphone users with its Boost Mobile and Virgin Mobile services.

The California Public Utilities Commission (CPUC) has scheduled three days of hearings starting February 5 on the transaction. At the hearings, the CPUC plans to ask Sprint and T-Mobile executives about merger-specific, verifiable efficiencies and the likelihood those benefits would offset the deal's detrimental effects, according to a commission memo.

Merger would drive lower prices, improved services, parties argue. In filings with utilities regulators in California and New York, the merging firms said a combined T-Mobile-Sprint 5G network would lead to dramatic improvements in data rates and coverage for Californians and New Yorkers and new investments in rural communities. The companies said they couldn't offer these same benefits if they remained separate.

T-Mobile and Sprint's efficiencies argument primarily rests on their plans to combine complementary spectrum assets: T-Mobile's low-band 600 MHz radio waves, Sprint's mid-band 2.5 GHz holdings and both companies' future high-band millimeter spectrum purchases. The merged company would have more flexibility than either carrier alone would have in quickly and broadly deploying 5G services while still serving existing 3G and LTE customers, the companies said.

T-Mobile has pledged to spend $40 billion post merger to create a viable 5G network. The company estimates that by 2024 it could offer three times the 5G capacity and as much as 5.8 times the throughput speeds, covering as much as 2.8 times more people, than it or Sprint could do separately, the companies said.

Without the merger, Sprint said it would mostly rely on its 2.5 GHz spectrum to create a 5G network. The mid-band radio waves' range is limited, and building more infrastructure to support a 2.5 GHz-based network would be expensive, the companies said. On its own, Sprint in 2024 could offer 5G services only in some spots of the country, according to the companies.

Lacking Sprint's spectrum, T-Mobile would base a 5G network on its 600MHz spectrum assets, the companies said. The low-band waves would ensure broad coverage but lack the capacity of the companies' combined spectrum assets, they said.

Efficiencies don't outweigh transaction's harms, opponents argue. In filings with the FCC, the merger's opponents said the carriers have exaggerated the efficiencies while downplaying the deal's harm. The T-Mobile economists' network model fails to factor in, among other things, future millimeter spectrum both companies plan to buy, according to rival Dish Network. When the high band radio waves are accounted for, the marginal cost savings of merging versus remaining apart are a "fraction" of what T-Mobile economists predicted they would be, Dish said.

The merger would lead to price increases of as much as nine percent for post-paid service, according to Dish, and almost 16 percent for prepaid plans, which attract low-income users.

The transaction would put more spectrum in the hands of fewer companies for the vast majority of New York and California residents, resulting in higher prices, according to the Communications Workers of America (CWA), a deal opponent. The union said post merger, 54 counties in New York accounting for 98 percent of the state's population would exceed the FCC's spectrum screen, a rough indicator of potential market concentration. The spectrum screen would be exceeded for 99 percent of California's population, CWA said, second only to Connecticut, where all residents would confront that level of concentration.

The merger would lead to significant job cuts in New York and California, according to CWA. The New York City and Los Angeles regions would be particularly hard hit, losing a net 1,512 and 1,645 jobs, respectively, CWA said.

Workers who do keep their jobs could see their wages decline as a result of the remaining wireless carriers facing less competition for labor, according to CWA, citing a report by the Economic Policy Institute and the Roosevelt Institute.

Some cable providers protest deal. Some cable providers have said the merger would give T-Mobile the power to harm discount wireless rivals. Altice, a cable and broadband provider that's a regional MVNO, said in an FCC filing the deal could harm its ability to become a national wireless carrier.

Altice relies on Sprint's network now to provide wireless services. If the merger is cleared, T-Mobile would be the biggest national wireless wholesaler. T-Mobile has "made no tangible commitments regarding meaningful support for current MVNO partners, including offering such partners the full nationwide network that the New T-Mobile will enjoy," according to the filing.

How much of a competitive threat T-Mobile finds cable companies in wireless services is an open question. The carrier has discussed Comcast and Charter Communications as rivals in public filings, but T-Mobile CEO John Legere has also called cable providers' market entry "a charade" and "very irrelevant."